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France can damage America in the Security Council. Nobody will benefit, France probably least of all ... More on this week's lead article

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Politics this week

Feb 27th 2003
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America, France and the Security Council

America tabled a draft UN resolution stating that **Iraq** had failed to take its “final opportunity”. France issued a memorandum calling for more time to be given to the inspection regime. Both vied to win Security Council support. George Bush said liberating Iraq would boost democracy in the Middle East. In Britain, more than 120 MPs rebelled against Tony Blair's support for the war option.

See article: The Iraq endgame

The chief weapons inspector, Hans Blix, demanded the destruction of Iraq's **missiles** which fly beyond an agreed limit. He also welcomed Iraq's release of more information about its arms programme, but said he had seen no evidence of a “fundamental” Iraqi decision to disarm. Saddam Hussein told an American television journalist that he had no weapons of mass destruction and would prefer death to exile.

AP

See article: In need of resolution

Turkey's government sought the approval of parliament to allow America to station over 60,000 troops in the country to fight in a war against Saddam. Turkey is negotiating a $15 billion package of grants and loans from America to hasten an agreement.

See article: Turkey and America reach a deal on Iraq

General Eric Shinseki, chief of staff of **America's army**, predicted that several hundred thousand soldiers might be required to feed the hungry and keep the peace after a victory in Iraq.

See article: Can America fight two-plus wars?

Israel's new coalition

Ariel Sharon formed a centre-right coalition government that is coming up with compromises on domestic Israeli issues but will probably block any progress towards a Palestinian settlement.

See article: Israel's coalition government

South Africa's budget promised lower taxes for the ill-paid, greater health spending and more privatisation, while predicting growth of 3.3%.

The UN accused **Congo's** government of blocking an investigation into allegations that it is continuing to support anti-Rwandan militiamen, despite having signed a pact promising not to. Under the terms of the pact, Rwanda's army has left Congolese territory.

The UN's latest **population** data project the impact of HIV/AIDS and of lower fertility rates on the developing world. The fertility level in most developing countries is expected to fall below replacement level. World population estimates for 2050 have now dropped by 0.4 billion to 8.9 billion.

Daley wins again

AP

Richard Daley was re-elected in a landslide to serve a fifth term as mayor of **Chicago**. He won 79% of the vote; his nearest rival rustled up a meagre 14%.

See article: Daley again in Chicago

Ninety-seven people died in a **night club** in West Warwick, Rhode Island, after a rock band's pyrotechnic display sparked a fire. Days later, ten people died in a fire at an old peoples' home in Hartford, Connecticut.

Austria tries again

Austria's Chancellor Wolfgang Schüssel and his centre-right People's Party were close to forming a coalition government with the right-wing populist Freedom Party—six months after the same coalition had collapsed because of feuds among the Freedomites. In the new partnership, Mr Schüssel's lot would have more power than before.

See article: Austria's new government

AP

Vojislav Seselj, a leading ultra-nationalist Serbian politician, surrendered to the UN's war-crimes tribunal at The Hague, where he has been charged with crimes against humanity allegedly committed in Bosnia, Croatia and Serbia between 1991 and 1993.

The UN's secretary-general, Kofi Annan, visited **Cyprus** in an effort to prod the Greeks and Turks towards a settlement—and said they could have another week to make up their minds whether to accept his revised plan for the divided island.

The **French** government challenged the European Union's authority by saying it would not adopt austerity measures required to close the country's public deficit, which is likely to exceed the EU's 3% limit.

Speaking at a gathering of African governments in Paris, France's president, **Jacques Chirac**, appeared to make a U-turn by calling for rich countries to stop subsidising their farmers' exports to poor ones.

Attention seeking

North Korea apparently restarted its mothballed Yongbyon nuclear reactor, but has not yet reactivated its processing plant at the site. Earlier, it launched a short-range missile into the sea on the day that South Korea's new president, Roh Moo-hyun, took office. The United States said the North was just trying to attract attention. As a gesture to the new president, who wants talks with North Korea, America said it would resume food aid to the North.

See article: And now for North Korea

At least 260 people were reported to have been killed in an earthquake in Xinjiang, in western **China**, one of the country's poorest regions.

Hong Kong imposed a tax of HK$400 ($51) a month on employers of foreign maids, to encourage the employment of local people.

Afghanistan and Myanmar are the world's largest producers of **opium**, according to the International Narcotics Control Board in its annual report.

Aceh became the first province in **Indonesia** to establish a criminal court based on sharia, the Islamic

law, which allows caning. More extreme punishments might not be allowed.

Hostage takers

In **Colombia**, the left-wing FARC rebels announced that they had taken hostage three Americans working for a Pentagon contractor. Extra American troops were deployed to find them.

See article: Americans are taken hostage in Colombia

Five people were injured when bombs, thought to have been set by supporters of the beleaguered president of **Venezuela**, Hugo Chávez, exploded at the Spanish and Colombian diplomatic missions in Caracas, the capital.

Reuters

See article: Violence returns to Venezuela

Brazil's centrist party, the PMDB, promised to support the reform plans of President Luiz Inácio Lula da Silva, giving him a healthy majority for these measures in Congress.

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Business this week

Feb 27th 2003
From The Economist print edition

Europe's Enron

A mammoth accounting scandal was uncovered at **Ahold**, the world's third-largest grocer. The Dutch company revealed that profits at an American business had been overstated by more than $500m over two years; its chief executive and chief financial officer resigned. Ahold's shares slumped by 63% in one day.

See article: A Dutch crown jewel tarnished

Kohlberg Kravis Roberts, an American private-equity group, withdrew from the contest to buy Safeway, a British supermarket chain, spurring rumours that it might transfer its affections to Six Continents, a British hotel and pub group. Hugh Osmond, a food-and-drink entrepreneur, had his proposed bid of up to £6 billion ($9.5 billion) firmly rebuffed by Six Continents; it will press ahead with plans to demerge.

Imprudential

Prudential gave the latest jolt to Europe's embattled insurers. Shares in Britain's second-biggest insurer plunged by 18% even though profits for 2002 increased by 2% to £1.1 billion ($1.7 billion). The Pru said that it would abandon its policy of increasing dividends above inflation. **Aviva**, Britain's biggest insurer, said that it lost £2.5 billion last year and cut its dividend.

Credit Suisse reported a loss of SFr3.3 billion ($2.1 billion) for 2002, compared with a profit of SFr1.6 billion the year before, despite heavy cost cutting. It announced a further 1,250 job cuts and a dividend cut but promised a “reasonable” profit this year.

See article: Credit Suisse slashes its costs

Swiss Re said that it expected a loss of SFr100m ($64.2m) in 2002 after taking a charge of SFr3.4 billion for the diving value of its share portfolio. The big reinsurer cut its dividend for the first time since 1906. **Zurich Financial**, Europe's fifth-largest insurer, lost $3.4 billion and also slashed its dividend.

Bitter pill

Roche made a surprisingly heavy loss of SFr4.0 billion ($2.6 billion) in 2002, mainly because weak stockmarkets had led to a thumping loss for the Swiss drug firm's investment portfolio.

Bayer's shares fell heavily after reports emerged that the German drug and chemicals firm's management knew of problems with Baycol, an anti-cholesterol treatment, some time before the product was recalled. Bayer faces several thousand lawsuits from people who had taken the drug.

The family business

Umberto Agnelli, brother of Gianni, who died last month, is set to take the wheel as **Fiat's** new chairman, returning the struggling industrial conglomerate to the management of its founding family. He will replace Paolo Fresco, who had been expected to stand down later in the year.

ABB reported a record annual loss of $787m after the Swiss-Swedish industrial giant took charges to settle asbestos-related liabilities.

EasyJet's shares fell by 12% after the low-cost airline admitted that average fares had fallen by 6% between October and January.

See article: Cheap airlines in trouble?

WPP, one of the world's leading advertising agencies, confirmed the sorry state of the advertising market: profits plunged by 68% last year to £88m ($133m). Sir Martin Sorrell, its chief executive, said that war in Iraq would slow any recovery this year.

See article: Green shoots or warning shots?

The wait to rate

America's three “nationally recognised” rating agencies welcomed a fourth member to their exclusive club. Canada's **Dominion Bond Rating Service's** application to join Moody's, Standard & Poor's and Fitch was accepted by the Securities and Exchange Commission after a two-year wait. Four other agencies hope to join the exalted bunch.

Four former executives at **Qwest**, America's fourth-largest local-phone company, were charged with fraud by federal prosecutors, for artificially boosting revenues.

Lawsuits were also filed against two former vice-presidents of **Kmart**, a bust grocery chain, on charges of conspiracy and making false statements to the Securities and Exchange Commission.

Bush's new adviser

Glenn Hubbard resigned as chairman of President George Bush's **Council of Economic Advisers**. He will be replaced by Gregory Mankiw, a Harvard economist.

Junichiro Koizumi, Japan's prime minister, appointed Toshihiko Fukui as the new governor of the **Bank of Japan**. The choice of a conservative was criticised as a timid response to Japan's problem of deflation; Mr Fukui is unlikely to diverge from his predecessor's policies.

See article: The only way is up

America's consumers look prepared to keep their wallets shut. Consumer confidence fell in February to its lowest level since October 1993, according to the Conference Board.

See article: Will war mean slump?

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America, France and the Security Council

The Iraq endgame

Feb 27th 2003
From The Economist print edition

France can damage America in the Security Council. Nobody will benefit, France probably least of all

Get article background

IN AN otherwise bleak moment for world diplomacy, here is a consoling thought. The diplomatic endgame is not going smoothly: the Security Council is split; Tony Blair's support for the war option has earned him a battering in the House of Commons. But it is at least an endgame. That is to say, within a matter of weeks the people of Iraq will probably no longer be under the thumb of the dictator who has ruled over them for more than 30 years. In fact, there seem to be only three ways for Saddam Hussein to stay in power much beyond March. One: he blinks at the last minute and surrenders his mass-killing weaponry in compliance with Resolution 1441. That would enable George Bush to declare a bloodless triumph and march his army home. Two: it is Mr Bush who blinks by dropping his threat to use force if Saddam does not comply. Three: Mr Bush waits to see whether the extra inspections France wants really can disarm Iraq peacefully.

As to one, Mr Hussein shows no sign of blinking yet. In a television interview this week, he said he would prefer death to exile and repeated his claim to have no weapons of mass destruction. He may change his tune when he is sure the alternative is destruction in an American-led invasion, but the new outbreak of disunity in the Security Council can only have made him feel that he has more time to play with.

If Iraq's president will not back down, can America's? Not likely. America, Britain and Spain have now tabled a short second resolution saying that Iraq has failed to comply with Resolution 1441. Mr Bush hopes the simplicity of the resolution will make it hard for the doubters on the Security Council to stand in its way. But he still says that even if the council refuses to pass the resolution (and it may refuse, see article), he will lead a “coalition of the willing” to disarm Iraq anyway. Having said this so many times, and mustered an invasion force on Iraq's borders, he cannot climb down now without harming both his own reputation and the credibility of America itself.

The French defence

What, then, about the third thing that might keep Saddam in power: the war-averting compromise put to the Security Council in a French memorandum and supported by Germany, Russia and China? This argues that the inspectors have only just started their work, are already making progress, and might still disarm Iraq peacefully if they have the time and resources. France says it accepts that the inspections must not go on indefinitely. But whereas the Americans have said that Iraq has “weeks rather than months” the French envisage at least four more months. And in the meantime they see no reason why they should support the new resolution from America, Britain and Spain, which by stating the obvious—Iraq is in breach of 1441—is plainly intended to pave the way for war.

It is no wonder that the French approach has broad appeal. Iraq's peaceful disarmament is the outcome everybody, including the Americans and British, says they want. But the idea that this can be achieved simply by increasing the time and resources for inspections is surely an illusion. Time and resources can make a difference to the outcome of the inspections only if you assume (a) that Saddam aims to hold on to his forbidden weapons and (b) that in spite of this, the inspectors will eventually be able to find them anyway.

If Saddam did not intend to hold on to any of his weapons, he could simply have given the UN the full and accurate declaration of what he had, as Resolution 1441 required. Instead, as Hans Blix, the chief inspector, has testified, he submitted a declaration full of unanswered questions. As to (b), if Iraq does not tell the inspectors where its weapons are, how can any number of inspectors know where to find them? Even if they found some, how would they know when they had found the lot? In its own memorandum, France acknowledges the need for the “full and active” co-operation Iraq has so far withheld. But handing the inspectors the odd “misplaced” biological bomb or batch of papers, as Iraq did this week, is a pretence of co-operation that could drag on for years.

How to make everyone a loser

You might think that only the credulous (or an inspector) would put as much faith as France's President Jacques Chirac now says he does in further inspections. But then only the credulous take the fight over the inspectors at face value. In fact this has become a proxy for two other arguments. One is whether a war would be justified even if it became absolutely clear that Saddam had no intention of disarming peacefully. The other stretches beyond the question of Iraq and has to do with how the rest of world plans to accommodate itself to post-cold-war, post-September 11th American power. On both issues, Mr Chirac can be forgiven for thinking that he is on a winning streak. On both he is probably riding for a fall.

On whether a war might be justified at some stage, Mr Chirac has so far been able to enjoy having it both ways. He is the toast of the peaceniks for having proposed a way to avoid a war many of them will oppose in any circumstances. But as the leader of one of Europe's martial nations, he has not ruled out French participation in a war if it should become plain that Saddam will not submit in any other way. This is fine work, while it lasts. But then? If the moment comes for France to throw in its lot with the war party, Mr Chirac will need a jolly good argument to explain his reversal to those who see him simply as the defender of the peace.

As to American power, Mr Chirac has won glowing reviews as the man who is doing a fair job of taking the superpower down a peg or two. France would not be France if its president did not occasionally try to puncture the grandiosity of an America accused as ever of taking the acquiescence of smaller nations for granted. But what if, now that he has picked this particular fight, Mr Chirac proceeds to lose it?

This could now happen in very short order. America and Britain have given themselves only a couple of weeks to pass their new resolution. Should they fail—either because they cannot muster a majority or because another of the permanent five casts a veto—Mr Bush will almost certainly feel compelled to fulfil his promise to go to war anyway. If the war goes badly, bringing disaster all round, Mr Chirac will be able to claim a barren sort of vindication. But if it goes even half-way towards achieving Mr Bush's vision of a democratic future for the Middle East (see article), France will have absented itself from a history-changing intervention in a part of the world where it has long claimed a special influence. It will also have demonstrated the impotence of the Security Council, the very institution from which the French (and British) derive so much standing by virtue of being veto-wielding members.

Some will say that Mr Chirac is right to run this risk to defend the integrity of the Security Council against the bullying of the Americans. But if this was his aim, Iraq was precisely the wrong fight for him to pick. Having defied the Security Council for a dozen years, Iraq's dictator has just failed to comply with a unanimous resolution threatening him with “serious consequences”. The integrity of the Security Council now depends on it allowing America to use its power to enforce the council's will, not on changing its mind in order to make the Americans resort to a “coalition of the willing” outside its authority. There is still time for Mr Chirac to reconsider. In both the world's interest and France's own, he should do so.

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European corporate malfeasance

Ahold out

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The Ahold scandal shows that Europe is not immune from America's corporate ills

AS THE post-Enron wave of corporate scandals washed over America last year, a common response in Europe was: it couldn't happen here. Far from having the world's best-policed markets, the United States, many European politicians claimed, suffered uniquely from a lethal combination of greedy and overpaid bosses, conflicted auditors and investment bankers, reliance on accounting rules not principles, and an obsession with quarterly profit numbers. In America, as many as 1,200 companies have been forced to restate their accounts in the past five years; in Europe the number is barely in double digits. So it is outrageous, many Europeans now argue, that America is seeking to impose the unwieldy Sarbanes-Oxley act, passed in the wake of Enron and WorldCom, on European companies listed in New York.

As more sensible European regulators recognise, this smugness was never justified: it is only necessary to recall scandals such as Vivendi, ABB, Elan and EM.TV. But Europe's claim of immunity from corporate sleaze has now been blown out of the water by this week's revelations that Royal Ahold of the Netherlands, the world's third-biggest food retailer, overstated its profits for 2001-02 by as much as $500m. Its chief executive and chief financial officer have both quit.

It is true that Ahold's accounting deficiencies mainly involved American subsidiaries that it bought in a decade-long acquisition binge (see article), though they also stretched to Argentina and Scandinavia. But the company's Amsterdam-based auditors, Deloitte & Touche, failed to pick the problems up in 2001, even though worries about Ahold's accounts were widely expressed in the markets for most of last year. Ahold's board, far from questioning the chief executive closely, tamely extended his term for up to seven years as recently as last spring. The Dutch market regulator admitted this week that it had no powers of discipline over faulty auditing.

What about the relative numbers of restatements? Because America's GAAP accounting system relies on thousands of pages of rules, it is more vulnerable to manipulation than Europe's more principles-based approach. Wall Street's excesses of the 1990s were also more egregious than Europe's. But given the largely non-existent regulation of auditors and the poor corporate governance prevalent in much of Europe, a more plausible conclusion is that Europe has had fewer accounting scandals than America mainly because nobody has seriously looked for them, not because they are not there.

This is not to say that Europe should adopt Sarbanes-Oxley *in toto.* That hastily drafted law was designed for America's very different system; it precludes the two-tier boards that are common in Europe, for example. Many of the law's rules on managers and boards seem unduly intrusive even for America. But statutory, independent regulation of auditors, as prescribed by Sarbanes-Oxley, makes sense everywhere. So do rules to stop accounting firms doing consulting work for audit clients; and it is also worth considering mandatory rotation of auditors (Deloitte had audited Ahold for 15 years).

The case for independent regulation is the stronger because European Union companies are due to adopt international accounting standards by 2005. It is little use taking this welcome step towards tougher standards, which the Europeans are urging on America in the interests of global harmonisation, if there is nobody to oversee the rules. Yet the European Federation of Accountants admits that, in six EU countries, there is in effect no enforcement at all.

Bad apples and oranges

After Enron and WorldCom were followed by the bankruptcy and criminal conviction of Andersen, which had audited both companies, the remaining Big Four hinted that Andersen had been an exceptional case: a rotten apple amid a barrel of good ones. Andersen does seem to have been peculiarly culpable. Yet most of the other firms have now also been tarnished by scandal in the past year or so: KPMG over Xerox, PricewaterhouseCoopers over Tyco, Deloitte over Adelphia, for example. This litany means that statutory regulation of auditors is now essential if investors are to regain their shattered confidence in the financial markets.

It is, in any event, pointless for politicians to crow about the merits of their respective systems. As companies such as Ahold go global, they run into countless national regulators and supervisors—and it is the weakest link that is always most likely to prove their (and their investors') undoing. The right response is to adopt the strongest, not the laxest, regimes possible. And that means both enforcement of international accounting standards and tough regulation of auditors.

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Japan

Muddleheart Koizumi

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His timidity may prove to be a gamble

Reuters

DID anyone still think that Japan's prime minister, Junichiro Koizumi, the self-styled “lionheart” who promised to “change Japan” when he first grabbed the job in April 2001, was really a brave reformer? If so, then the choice he announced this week as the new governor of the Bank of Japan, Toshihiko Fukui, ought to have been the final disillusionment. Even though Mr Koizumi declared little more than a month ago that he wanted to pick a tough “deflation-fighter”, this appointment of a former Bank veteran who is close to the current, much-criticised governor, Masaru Hayami, was a cautious move, bang in line with Japanese bureaucratic and political tradition. If Mr Koizumi still thinks he is a lion, he plainly has in mind the creature from “The Wizard of Oz” who asked Dorothy to help him find his courage.

Choosing Mr Fukui was not necessarily a bad move: he is a respectable and highly capable man (see article). It is always possible that an insider, who is trusted both in the central bank and in the finance ministry, could prove more able to implement adventurous monetary policies than would an outsider whose declared radicalism might make the establishment gang up against him. That is possible; but if it were to happen it would certainly be a novelty. What Mr Koizumi lost by this appointment was the chance to show that he really does want novelty, that he truly wants to change Japan.

But does Japan actually want to be changed? After a decade of stagnant economic growth, gradually rising unemployment, highly indebted companies, a massively indebted government and seemingly remorseless deflation that may seem a strange question to ask. Yet, although Japanese officials, politicians and commentators talk constantly about the need for reform, their actions—or, rather, inaction—suggests that they don't believe what they are saying. In Japanese culture, the *tatemae*, or appearance, is often far removed from the *honne*, or reality. So it is with reform. Everyone says it is urgent. The *honne* is that slow change, in a spirit of muddling through, feels much more comfortable, including to Mr Koizumi.

It might work, up to a point. A bit of further monetary expansion, in line with Mr Hayami's policies, may restrain or even halt deflation. A bit more public spending might add to demand. A bit of banking reform might help revive lending and restore investors' confidence. Cheaper oil and a recovering world economy after a successful war in Iraq might boost Japanese exports and allow the yen to resume its helpful fall that was recently halted by the weakness of the dollar.

Such muddling through would not cure Japan's fundamental ills—its huge surplus of savings, relative to demand, and the political and economic paralysis created by powerful interest groups—but it could buy time until a slightly stronger economy and a weaker yen make a cure easier to impose and easier to take. But what if it doesn't? Those ills are so profound that they will require an immense effort to cure. And meanwhile the combination of high public and private debts and steady deflation is making Japan vulnerable not just to a debilitating illness, as for the past decade, but to a cardiac arrest.

Like many political leaders, Mr Koizumi has proved to be much braver in his foreign policy than at home. By breaking so many of his promises of domestic reform, he has not necessarily destined Japan for economic decline or disaster. But he is taking the risk that a shock caused at home or abroad might eventually produce just that. It is courageous, in a way.

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Bend it, break it

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Just as much a danger, in its own way, as Iraq and North Korea

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THERE is no more certain way to blow apart the edifice of treaties and agreements that help to stop the spread of weapons of mass destruction, especially nuclear ones, than to let their rules be violated with impunity. The Security Council therefore insists that Iraq be stripped of illicit weapons, though it still disagrees over whether this can be done by inspection or now only by force. North Korea's recent confession that it had been breaking its non-nuclear vows, and news that it had restarted its reactor at Yongbyon, are proving equally difficult to deal with. Yet by bothering to flounce out of the Nuclear Non-Proliferation Treaty (NPT), defiant North Korea seemed to imply that the rules still matter. Do they?

Just as damaging to the NPT as the confessions of such serial rule-breakers are suspicions that Iran is managing to bend the treaty's peaceful provisions to build a bomb. India showed the way, using its nuclear-power programme as cover to work up the skills needed for weapons-making. Its nuclear tests in 1998 harmed the anti-proliferation cause, not least because it paid so little in its international standing for having done so. But India, like Israel and Pakistan, has remained outside the NPT. Allowing a country to get away with that from the inside would be hugely more damaging.

Iran scoffs at such accusations. Officials from the International Atomic Energy Agency (IAEA) have been there this week looking at some nuclear facilities that have troubled them, including a new uranium-enrichment plant. Oughtn't the world to applaud Iran's readiness to let them in? Not at all. Every other country with one of the IAEA's comprehensive safeguards agreements now automatically informs it of planned nuclear facilities before they are even built. The ones the inspectors were looking at this week were first disclosed not by the Iranian government but by an opposition group that accuses it of clandestine bomb-tinkering. And even if Iran now starts giving more such information to the IAEA earlier, as it says it will, the agency will still have no way of knowing whether its professed peaceful intentions are true or false.

That is because Iran refuses to sign up to tough new safeguards introduced after the 1991 Gulf war, when inspectors discovered that Iraq had come perilously close to having a bomb without their knowing. Under the new rules, they have a licence to snoop where they choose, not just at “declared” sites, where governments admit there is uranium or plutonium. And they can also use sophisticated new techniques to catch cheats. Until Iran accepts these rules, inspectors visiting places where the government invites them in will be unable to tell if a bomb is being built next door.

Understandably, worried outsiders keep asking why a country with large oil and gas reserves is sinking so much scarce cash into costly nuclear power. Iran plans to add several more nuclear reactors to one being completed by Russian companies at Bushehr. Keen to deflect accusations that Bushehr provides Iran with cover for a covert weapons programme, Russia says it will provide all the fuel for the reactor, taking back the spent fuel-rods to prevent any diversion of their fissile lode. But Iran anyway insists it will do its own fuel-making, thank you. In the process it will eventually get its hands on plenty of enriched uranium and bomb-usable plutonium.

Defend it or lose it

One way to bolster the NPT would be to cut off nuclear dealings with countries, like Iran, that refuse the toughened inspections. But even without breaking the treaty's rules, any country with sophisticated nuclear skills may now be able to bend them enough to ready itself for a quick break-out (withdrawal from the treaty requires only three months' notice). Whether such countries dare to do so will depend in part on whether Iraq and North Korea get away with it. Let either of them off the hook, and others, not just Iran, may be emboldened to try. And then, whether it has been broken from without or bent from within, the NPT will surely collapse.

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Democracy and ethnic strife

Museveni's conversion

Feb 27th 2003
From The Economist print edition

Multi-party democracy's most plausible opponent changes his mind

EVERYONE wants democracy, and everyone wants peace. But what if the two dreams are in conflict? If people identify themselves more closely with their tribe or faith than with their country, political parties can become the means of promoting narrow communal interests, or, worse, fomenting ethnic grievances. From Northern Ireland to Sri Lanka, this has often led to bloodshed. The problem is sharpest in Africa, where most borders were drawn up by white empire-builders, who casually split some ethnic groups between different states, and lumped others together with neighbours they disliked.

Uganda's president, Yoweri Museveni, has long argued that party politics inflame matters. In young states such as his own, he has said, it is foolish to expect political parties to represent anything but tribes. They cannot represent different socio-economic classes, because virtually all voters are peasants. They cannot represent different ideologies, because a barely literate population knows no ideology save deference to the local chief. Tribally based parties invariably aggravate ethnic divisions, and this often leads to civil war. So all parties should be banned, as in effect they are in Uganda, until the people are mature enough to cope with pluralism.

Mr Museveni's thesis has received a more sympathetic hearing than you might expect. This is partly because he has done such a good job of running Uganda, but also because so many African political parties are indeed incorrigibly tribal. A decade after embracing multi-partyism, Côte d'Ivoire is cursed with a president who has written a book on why his ethnic group is superior. Not coincidentally, the country is at war. Since democracy returned to Nigeria in 1999, some 10,000 people have died in tribal and religious riots, as chauvinistic politicians invoke communal loyalties to win votes.

So it is significant that Mr Museveni has apparently changed his mind (see article). If he goes ahead and lifts his restrictions on political parties, he will deserve applause. For multi-ethnic states do not necessarily need autocratic governments to hold them together. Several academic studies suggest the opposite: that ethnic diversity slows economic growth in undemocratic states, but makes little difference in democracies. The reason may be that people who do not feel oppressed are unlikely to blame the tribe next door for their oppression.

Why can't we all just get along?

That said, there are risks to pluralism, and Mr Museveni should take certain precautions. A first-past-the-post, winner-takes-all voting system may work in practised democracies such as Britain, but could be disastrous in Uganda, as it would simply allow one or two big tribes to dominate the rest. Far better to have rules that ensure that all groups have a stake in government, through proportional representation, for example, or by insisting that presidential candidates must gain a measure of support from all parts of the country. In Nigeria, such rules have hardly brought perfect harmony, but have probably helped prevent a repeat of the civil war of 1967-70.

Mr Museveni may also consider granting greater regional autonomy. Power is too centralised throughout Africa; if, instead, regions were self-governing and self-financing, they would have only themselves to blame if things did not go well. Such devolution is one reason why Switzerland's tribes have not slaughtered each other for centuries. Africa has the opportunity to learn from its own, and others',

mistakes.

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Letters

Feb 27th 2003
From The Economist print edition

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Oceans apart?

SIR – You speak mystically of vast tectonic shifts in the relationship between the United States and the European Union in an attempt to explain the lack of consensus regarding war on Iraq ("How deep is the rift?", February 15th).

Instead, you might have asked how is it that the Bush administration has managed to squander the almost universal support, sympathy and goodwill of people around the world following the unprovoked terrorist attacks on the twin towers? The answer would have led you to a more substantial conclusion. Through incompetent diplomacy and mind-numbing assaults on democratic principles, both embodied in his own doctrine of unilateralism, George Bush has managed to alienate millions of citizens of Europe and America. I do not detect a rift between the peoples of America and Europe but there is a glaring rift between the leaders of the democracies of Europe, who must respond to the will of the majority, and Mr Bush, who believes he need not.

William Partridge
Nashville, Tennessee

SIR – You place all the blame for the rift on France and Germany, and ignore America's own diplomatic "stomping". Surely the Bush administration is the clumsiest in recent memory, with Condoleezza Rice and Donald Rumsfeld torpedoing Colin Powell's attempts to persuade and convince with their brusque language and offensive lack of respect for other countries? How can doubters be expected to vote for another UN resolution when Ms Rice says America will go to war anyway? How can countries that have serious reservations be persuaded of America's case when they are dismissed as "old Europe"?

David Pritchard
Madrid

SIR – Talk of a "transatlantic crisis" is misleading. While it is true that a European popular consensus disagrees with America over the best way to deal with Iraq, there is clearly an overwhelming European consensus which believes that maintaining the transatlantic collective-security connection is a vital necessity in a dangerous world. France has been allowed for too long to exploit the complex relationship between the EU and NATO in order to generate "transatlantic crises" in pursuit of its particular anti-American European goals. It would be far better for the collective security of the rest of Europe if NATO were reshaped and strengthened without France.

Clive Christie
Hull

Statuesque

SIR – As a lifelong Richmond-area resident and member of the Sons of Confederate Veterans, I have no objection to the idea of a statue of Abraham Lincoln here ("Abe just ain't right", February 15th). His visit to Richmond was an historic occasion. My Confederate great-grandfather's internment was probably lengthened by Lincoln's approval of the termination of prisoner-of-war exchanges but my pride in his service does not require me to hate anyone.

Opposition to the statue of Arthur Ashe was primarily because of location. Putting a 20th-century sporting figure in a line of 19th-century military, political and scientific leaders is like placing modern art next to traditional. Other locations suggested were the Byrd Park municipal tennis courts or the Arthur Ashe Sports Centre, both located on a heavily used road not far from Monument Avenue.

Walter Dunn Tucker
Richmond, Virginia

Hunting Nazis

SIR – Was Joseph Goebbels really the man responsible for bagging the hunting trophies you mention ("Animal attraction", February 15th)? I venture that you have confused Goebbels with Hermann Goering, whose panoply of titles included *Reichsjaegermeister* (Reich chief huntsman).

Peter Best
Highcliffe, Dorset

Ratings and regulation

SIR – Your article on credit-rating agencies fails to note that Standard & Poor's has had an unblemished record for over 35 years of managing potential conflicts of interest that might arise through the payment of fees to us by rated issuers ("Let go of nanny", February 8th). Ratings are performed by committees upon the input of data from analysts who have no financial stake in the outcome. The end product and its rationale are subject to intense review by external users such as analysts and journalists. This transparent process is intended to, and does, negate the risks you mention.

We agree that the embodiment of ratings in regulation may, in some cases, cause investors not to perform their own analysis. Our experience has shown, however, that ratings are a valuable part of the total decision-making process of conscientious investors. This is a more compelling statement by far about why ratings have such significant impact on investors than that they have been embodied in some regulations surrounding capital allocation. The latter was a result of their reliability and usage; it would not bother us in the least if these regulations were dissolved.

Vickie Tillman
Head of ratings services
Standard & Poor's
New York

Measuring the good life

SIR – You cite Robert Gordon's research comparing real living standards in Europe and America after accounting for broader measures of economic welfare (Economics focus, February 8th). He excludes higher access in Europe to key public goods such as health care and education. Europeans pay for these through higher taxes but if one adds these public goods to a broader measure of living standards, it would not be surprising if the median European is in fact better off than his American counterpart. If we include access to culture, it would make Europeans look even better off.

Julian Karaguesian
Ottawa

SIR – Mr Gordon says that Europeans' living standards are higher than represented by GDP because they have more leisure time, fewer prisons, less air conditioning and better mass transportation. However we could just as easily say, for example, that the freedom to drive your own car and stop when and where you like is much more efficient than mass transit that does not take you where you want to go. Mr Gordon is simply revising GDP according to his own bias. It is a rehashing of the old socialist philosophy that all goods and services should be arbitrarily revalued by a central authority, in this case Mr Gordon.

Lowell Campbell
Carlsbad, California

Music sales

SIR – I cannot share your lament for "The death of the jingle" in favour of real pop (February 8th). Traditional jingles were never any good but were the only option when pop stars refused to stoop to crass advertising. Those days are long gone and now advertisers are seizing on the relative quality—and, no doubt, effectiveness—of well-known pop songs. After all, jingle-writers were only second-class musicians or they would be pop stars too.

Thad McBride
Washington, DC

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Dealing with Iraq

The quality of consensus strained

Feb 27th 2003
From The Economist print edition

Argument, sniping, arm-twisting: it all moves back to the Security Council

Get article background

THE campaign by President George Bush to see Iraq disarmed of weapons of mass destruction, come what may, has always had many fronts other than the military one. On February 26th, Mr Bush sought to quiet criticism that his determination to deal with Iraq was leading him to neglect two equally thorny problems: how to advance peace between Israelis and Palestinians, and what to do with Iraq after a war that may be only a matter of weeks away. On the first, he made rather general promises; on the second, he sounded a much bolder note as a liberator, democrat and nation-builder, not a conqueror or bully (see article).

Whether or not he manages to appease his critics on these points, Mr Bush faces an uphill struggle to achieve his other immediate objective: getting a second resolution through the United Nations Security Council. Governments of many countries, including Britain, his close ally in both arms and diplomacy, would prefer to have such council backing, if only to persuade reluctant publics and rebellious parliaments that military action to disarm Iraq would be justified.

Neither Mr Bush nor Mr Blair feels much need for extra legal cover. The UN's Resolution 1441, passed unanimously in November, promised “serious consequences” if Iraq failed to take this “final opportunity” to disarm: diplomatic language understood by everyone, at the time, to mean that an Iraqi refusal to comply would be met with force. However, Mr Bush too sees the value, politically and diplomatically, of working for as much UN consensus as possible, if only to make it easier for other countries and organisations to join in the reconstruction of Iraq once any war is over.

To that end, on February 24th the United States, Britain and Spain jointly tabled a draft resolution that they hope will come to a vote shortly after Hans Blix, the UN's chief weapons-inspector for Iraq, next addresses the Security Council on March 7th. The resolution, which reminds everyone that Saddam Hussein was given his final opportunity to disarm last November, and concludes that he has “failed to take that final opportunity”, has been deliberately pitched to draw as much support as possible. Even those who doubt the wisdom of fighting a war about it would not argue that Mr Hussein has yet done what was asked of him. To pass, the resolution needs to attract nine votes from the 15-member council and no vetoes from its permanent members (who, apart from America and Britain, include France, Russia and China). That still looks a tall order, on both counts.

This should really be seen as “an up and down vote on whether or not the Security Council is going to reinforce Resolution 1441,” argued Condoleezza Rice, Mr Bush's national security adviser, this week. But although that resolution put the onus squarely on Iraq to disarm, not on the UN's inspectors to catch him cheating, several governments, including that of France, have since backtracked. Although Britain's

prime minister, Tony Blair, this week declared it “absurd” to expect the inspectors to be able to diasarm Iraq without its proper and full co-operation, Germany's Gerhard Schröder and France's Jacques Chirac emerged from a meeting in Berlin to say the opposite: that inspections could still disarm Iraq peacefully. “We see no reason in this context to change our logic, which is the logic of peace, and switch to the logic of war,” they added.

Indeed France, whose determination to block UN approval of American action against Iraq has split both the transatlantic alliance and the European Union, has implied it might use its veto. That, said America's ambassador to France this week, would be considered “an unfriendly act”. Akin to a bullet in the back, agreed one of Mr Chirac's worried parliamentary allies.

So far, the only certain No vote is Syria's. But this week France, backed by Germany and so far by Russia too, put forward a “memorandum” which, it hopes, will block any chance of council support for military action by instead winning agreement to extend inspections in Iraq for at least four months more. Although the paper acknowledges that inspections “cannot continue indefinitely”, it calls for inspectors to be given more help, and for Iraq to be given a list by March 1st of things it must do—something inspectors have avoided in the past, since it removes, in effect, the obligation on Iraq to disclose fully all aspects of its hidden weapons programmes.

If France could stir up enough opposition to the new draft resolution, it could hope to defeat it in the Security Council without having to use an “unfriendly” veto. Might it manage to achieve that? Of the remaining council members apart from America, Britain and Spain, only Bulgaria has thrown its full weight behind the draft resolution so far; China has been havering; Mexico is dithering (see article). That still leaves Angola, Cameroon, Chile, Guinea and Pakistan to play for, and both sides have been lobbying them hard.

Might the inspectors make up their minds for them? Mr Blix has been keen not to seem to turn down the extra help that France and others want to give him. But he has emphasised in the past that it is not his job to play cat-and-mouse with the Iraqi regime, and that no number of inspectors can substitute for Iraq's willingness to co-operate in its own disarmament. That seems unlikely to happen at this late stage, though both America and Britain are still taking care not to be seen to rule it out.

Mr Hussein, meanwhile, is considering what to do about a letter from Mr Blix demanding that by Saturday he start destroying his al-Samoud 2 rockets and several hundred illegally imported missile engines. The inspectors have determined that the rockets are capable of flying beyond the 150km limit the UN has imposed on Iraq's missiles. But Mr Hussein seemed to indicate in an interview with CBS News this week that he might refuse. “We do not have missiles that go beyond the proscribed range,” he insisted. No doubt the Iraqi top brass, fearing a war, would like to hang on to such weaponry. But Mr Hussein also knows that a refusal to comply would go down badly even with countries that have been reluctant to endorse the use of force against Iraq.

Perhaps hoping to mollify any hardening opinion, Iraq has sent the inspectors six letters including extra information (its officials say) to back up its claims to have destroyed chemical and biological weapons unilaterally after the last Gulf war. It has also reported recovering a bomb containing unspecified “liquid” from a site where it says biological weapons were destroyed. What it has not provided is the mass of documents that inspectors have always suspected exist in government files. Those will tell a fuller story about what Iraq did with the illicit weapons it produced, and in what quantities it produced them.

For Iraq, persuading the world that it is worth continuing with inspections, however slowly it ekes out its co-operation with them, is its main diplomatic line of defence against a war. Yet it is hard to argue, as the French memorandum on reinforced inspections did this week, that inspections are currently working “without hindrance”. When he next reports to the council, Mr Blix will no doubt explain where Iraq has co-operated and where it has not. But one thing he has never formally asked the council for is more time for inspections. Whether that can really make the difference in disarming Iraq is something he would evidently prefer council members to decide for themselves.

Though both France and Russia have left themselves room to change their minds on the issue (as Germany has not), they now have little time in which to do it. Both America and Britain continue to insist that if the council refuses to enforce Resolution 1441, they will do so, and quickly too. The chances of keeping the Security Council united behind them look perilously slim.

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The Kurds, Iraq and war

Sitting ducks?

Feb 27th 2003 | CHAMCHAMAL AND KALAK
From The Economist print edition

Preparations for war in northern Iraq

Get article background

KURDISH agents and traders who pass through the checkpoints at Chamchamal and Kalak, the nearest Kurd-controlled points to Kirkuk and Mosul, report back on Saddam Hussein's preparations for defending the two northern cities. Kirkuk, which the Kurds briefly seized at the end of the Gulf war, has oil, as does the area round Mosul, which also controls a vital pipeline. Mr Hussein, says one Kurdish informant, is turning the towns into vast human shields.

According to these reports, residents have been ordered to stock up on food; once the fighting starts, those who venture outside will be shot. The army has put anti-aircraft batteries on the roofs of apartment buildings, while Baath Party and intelligence offices have been moved to secret places. Some say that Kirkuk's oil wells have been mined. In Kirkuk, the Iraqis are said to have built bunkers in Kurdish areas and are manning them with a home guard, reportedly of press-ganged locals. Mosul has a similar home-guard force.

The ruling factions in the autonomous zone, the PUK and the KDP, have had to promise the Americans and Turks that, this time, they will not make a lunge for either Kirkuk and Mosul. Turkey, in particular, is greatly concerned to prevent the oilfields from falling into Kurdish hands.

Even so, once the cities have been taken by the Americans, the PUK and the KDP intend to encourage tens of thousands of Kurds, expelled under Mr Hussein's policy of Arabisation, to return and reclaim their homes from the Arab Iraqis now occupying them. A smaller number of Turkmen, in whose welfare Turkey expresses fraternal interest, intend to do the same. Civil war could ensue, providing Turkey with yet another pretext to intervene. Around Mosul, where three Kurdish tribal chiefs support Mr Hussein, Kurds may kill each other.

If or when war breaks out, a mass exodus from Kurdish cities to the hills is expected. PUK and KDP officials are starting to warn people about Iraqi chemical attacks. But requests for gas masks and other protective equipment have been deferred by America and the EU, wary that help will imply political recognition. Foreign NGOs, reluctant to give the impression that war is inevitable, are not helping either.

Historically accustomed to isolation, Kurds wince at reports that Turkey, far to the north, is to receive early-warning aircraft and chemical-weapons defences from its NATO partners. Those same Turks, according to Kurdish officials, have vetoed Kurdish requests for defensive weapons. Local reports suggest that Iraqi missiles, possibly Scuds, have been brought to within easy range of the main towns in the autonomous zone. The Kurds, says a foreign-aid worker, are sitting ducks.

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Turkey and the United States

The end of the dance

Feb 27th 2003 | ANKARA
From The Economist print edition

Turkey gets cash and a handle on the Kurds; America gets a free hand

Get article background

IT WAS a question of choosing the lesser of two evils. Should Turkey side with America in a war against Saddam Hussein, or not? After months of prevarication, the ruling Justice and Development Party, in close consultation with the country's powerful generals, has reluctantly concluded that it is in Turkey's best interests to stick with its closest and most powerful ally.

On February 25th, the government handed a motion to parliament to allow the deployment of 62,000 American combat troops from Turkish soil into Iraq (an unspecified number of Turkish soldiers, perhaps as many as 40,000, will also go into Kurdish-controlled northern Iraq). The government had not yet struck a final deal on a package from the Americans that would cushion the effects of a war on Turkey's wobbly economy, and had reached no precise agreement on what the Turkish army will do in the mountains of northern Iraq. In effect, it had given in to America's unrelenting pressure.

The parliament, where the ruling party (better known as AK, initials that spell “clean” or “white” in Turkish) has a firm majority, was expected to vote on the motion by February 28th, as *The Economist* went to press. Despite divisions within AK—many of whose members, including the party chairman, Tayyip Erdogan, and the prime minister, Abdullah Gul, began their political careers in a party that was vigorously Islamist and hardly pro-American—the bill was expected to pass.

If it does, the Pentagon's planners will have secured the greatest strategic prize of all in their campaign to overthrow Saddam Hussein. Using Turkey as a springboard, thousands of American troops will be able to pour into northern Iraq, where they can open a second front against their Iraqi adversaries. A northern front should not only accelerate victory and reduce the number of American casualties, but will enable the Americans to take control of the oilfields around Kirkuk and Mosul. A swift enough takeover of the oilfields would prevent an attempt by the Iraqi leader to blow them up, and stop the Turks and Kurds from arriving there first and getting into a fight for them. Not least, with Turkey on their side, the Americans hope to prove to the broader Muslim world that this is a war against Saddam Hussein's brutal policies, not against Islam.

What will Turkey gain? The AK's leaders have had huge trouble explaining that part to a largely anti-war public. Most polls show well over 90% of Turks opposed to a war with Saddam. Bulent Arinc, the fiery AK speaker of the parliament—who, together with millions of other Turks, flicks his lights on and off every night at 8 o'clock by way of protest—has been threatening to sit on the bill until a second UN resolution is passed. The president, Ahmet Necdet Sezer, commented this week that “the real cost of war will be fully understood when corpses start coming home.”

It is the economic cost to Turkey that troubles officials most. Turkey is only just beginning to shake off the effects of a two-year recession in which the value of the lira fell by half and thousands of Turks lost their jobs, 301,000 in the latest quarter alone. One of the country's rare hard-currency earners, the tourist industry, has already been hit by the looming conflict, with bookings for this year cancelled by the thousands. All in all, the Union of Turkish Chambers of Commerce reckons the war will cost the country $16 billion.

From the generals' point of view, the bigger threat is what happens in northern Iraq. They are convinced that the Iraqi Kurds' “secret agenda”, tacitly blessed by America, is to declare their independence once Mr Hussein has been overthrown, and that Turkey's own Kurds will then try to join them. That is why they are insisting on sending tens of thousands of Turkish troops into the Kurdish part of Iraq.

With the Bush administration apparently determined to take on Saddam, Turkey's economy is set to suffer in the short term anyway. Better, then, to shake hands with the Americans and get some money. And better still if the Americans agree to let Turkish troops into northern Iraq, together with a solid promise that the United States will not back Kurdish independence.

That is what the AK government has been holding out for during weeks of tense negotiations. In the event, the United States has agreed to give Turkey $6 billion in grants and $24 billion in loan guarantees. The last remaining hitch was that Turkey, as of February 26th, was still resisting American demands that the package be supervised by the IMF. And, amid cries of betrayal from the Iraqi Kurds, the Americans have also bowed to Turkish demands to set up a *cordon sanitaire*, perhaps as deep as 40km (25 miles), inside northern Iraq. (The Americans have agreed to arm and disarm the Kurds in the presence of the Turks, who wanted to take charge of this themselves.) A final Turkish condition, at which the Americans balked, was that everything should be put in writing.

This long wrangling, which has left a sour taste in American mouths, has nonetheless reinforced the feeling of most Turks that AK has done its best to protect the national interest. But worrying questions remain. What if the Iraqi Kurds make good their threat to resist the Turkish troops? The Kurds may be no match for the Turkish army, but they could still bog them down in another guerrilla war, aided and abetted by the 5,000 or so Turkish-Kurd fighters based in their territory.

And what of relations with Europe? Since France and Germany are still opposed to war, though many other Europeans are not, will Turkey's collaboration with America poison its chances of joining the European Union? The Turks can only hope that a swift American victory will put paid to headaches like that—a victory made easier, of course, by Turkey's help.

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Fighting on two (or more) fronts

Four's a crowd

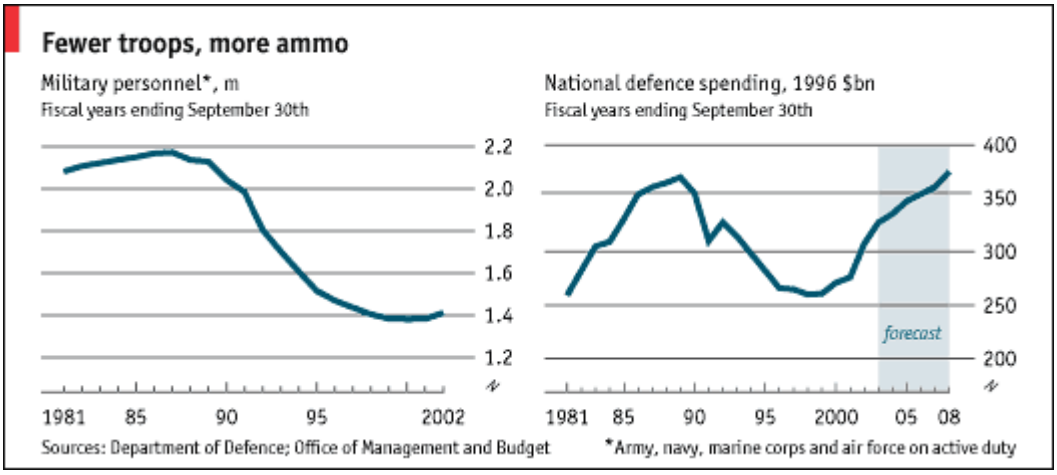
Feb 27th 2003
From The Economist print edition

With estimates of the cost of a war in Iraq rising, and North Korea sabre-rattling, an old question has re-emerged: can the global policeman really do it all?

FOR a decade after the cold war ended, the Pentagon based its military planning on the notion that America might have to fight two sizeable, overlapping wars in north-east and south-west Asia—in other words, against North Korea and Iraq. Iraq's stubbornness and North Korea's brinkmanship, just repeated in the latter's firing of a missile into the Sea of Japan, have made the question of whether America could do the two-war job sharper than ever. The short answer is “yes, but”.

Given that America's defence spending could soon equal that of the rest of the world combined, it may seem frivolous to ask whether it could defeat the obsolescent armies of Iraq and North Korea. Even the financial advantage does not convey the overwhelming pre-eminence that technology has conferred on America since the collapse of the Soviet Union.

Pessimists point to the fact that in human terms the American armed forces shrank between the death of the evil empire and the discovery of the axis of evil. The number of active-duty servicemen declined by about a third during the 1990s (see chart): it is now down to around 1.4m. Iraq's army has about 350,000 men (likely to be doubled or more by reserves) and North Korea has 1m regular troops (with millions more in reserve). Meanwhile, America's overseas commitments are almost as demanding as ever. Plenty of American troops remain stationed in Germany and Asia (with 37,000 in South Korea). They serve as “advisers” in various countries in South America, and help to keep the peace in Bosnia and Kosovo.



All the same, if defeating Saddam Hussein and Kim Jong Il were the only big things America had to worry about, its ten army divisions, its three marine divisions and its overwhelming air power would be sufficient. The numerical superiority of the Iraqi and North Korean armies would be no compensation for America's vastly superior weapons. The Iraqi army is much weaker, in conventional terms, than it was before the Gulf war of 1991, when it was routed. South Korea's army, sniffed at by the Pentagon's war-planners, could probably hold off an invasion from the North—or better—until the American cavalry arrived.

There would be difficulties. Just getting the troops to two conflicts that began simultaneously would be tricky: the assembly of one invasion force in the Gulf has been a ponderous business. Intelligence-gathering equipment, such as spy satellites and reconnaissance aircraft, would be spread thin. The strain would be taken by America's reserves and its National Guard, 168,000 of whose members have already been mobilised. They do much of the unglamorous donkey-work, and the burden laid on their shoulders has grown as the full-time force has shrunk.

America would not necessarily win the two wars as swiftly and bloodlessly as the doctrinal requirements of America's top brass suggest, and as ordinary Americans have come to expect. Even apart from its nuclear threat, North Korea's missiles and artillery could do much damage in the South. Yet the Americans would still win; so the basic answer to the two-fronts question is, yes, America can successfully fight Iraq and North Korea at the same time.

The “but” has to do with the fact that merely ousting Mr Hussein and neutralising Mr Kim would not be all America's generals had to worry about. For one thing, there would be the reconstruction of Iraq. On February 25th, General Eric Shinseki, the army's chief of staff, predicted that lots of soldiers—maybe several hundred thousand—might be needed to feed the hungry and prevent internecine blood-letting. If other countries fail to share the burden, sustaining that sort of commitment would be enormously difficult for America even if the rest of the world were quiet. If American troops had to be diverted to the Korean peninsula, it would probably be impossible.

Such a large post-war presence would also bump up the financial cost of an Iraqi war—a growing worry for the White House. In the Gulf war of 1991, other countries picked up much of the bill. This time America may have to pay as well as fight. This week the best guess for the cost of the war—including the aid offered to Turkey—jumped to around $100 billion, double Donald Rumsfeld's estimate in January.

Another part of the “but” is the problem that any wars against Iraq and North Korea should probably be counted as America's third and fourth wars. Its troops are already fighting a “war against terrorism”, and mopping up after the war in Afghanistan. Fighting two conventional enemies may be more difficult if you are also still grappling with the elusive al-Qaeda.

Look behind you

In theory, this was recognised, in 2001, in a reworking of the old two-war rule. It was then decided that the doctrine should change, given the crumbling state of the Iraqi and North Korean armed forces, the relative improbability (as it then appeared) of two simultaneous conflicts, and the emerging new threats to American security. The Pentagon's new brief is to defeat and overthrow one enemy swiftly, beat another one, and meanwhile be able to attend to sundry other contingencies.

But this theoretical change has not, so far, made much difference to the structure of America's armed forces. That, some say, is the problem: those forces are still too much built for yesterday's wars, and not enough for tomorrow's.

Take the Department of Defence's recent $380-billion budget proposal for 2004, which would raise spending back up to the levels of late cold-war munificence in real terms (a figure that does not include any provision for the costs of an Iraqi war). The budget is supposed to exemplify the Pentagon's commitment to “transformation”—the buzzword for building nimbler, better-informed armed forces, able to work together and project American power from a distance against, say, international terrorists. There is more money for transformational things like unmanned aerial vehicles. But as Andrew Krepinevich, a transformation advocate at the Centre for Strategic and Budgetary Assessments, argues, the Pentagon is still spending too much on old-fashioned systems, such as short-range tactical aircraft.

A lower-tech and more immediate military worry is whether the country's political leaders can cope if several balloons go up together. Clark Murdock, of the Centre for Strategic and International Studies, argues that the “scarcest commodity is the time and attention of senior leadership”. In the second world war, leaders such as Roosevelt and Churchill coped with troubles on many fronts. But the flood of information that now pours in (to electorates as well as to generals) has changed the nature of crisis-management. It may be harder to cope with several fights at once.

How is the Bush administration doing? The commitment of more military “advisers” to help the Philippines tackle Abu Sayyaf, an Islamist terrorist group (see article), seems partly designed to show that the administration can keep its eye on several things simultaneously. Against this, critics, such as Dan Plesch of the Royal United Services Institute in London, argue that Afghanistan “has dropped off the radar screens of the high political command”. The White House has also been criticised for dithering on North Korea because it wants to concentrate on Iraq. And all this is before the fighting has begun.

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America's plans for the Middle East

Birth of a Bush doctrine?

Feb 27th 2003 | WASHINGTON, DC
From The Economist print edition

The president stakes out a claim of enormous ambition in Iraq and beyond

AP

Go forth and democratise

Get article background

IT WAS not the Balfour Declaration or Churchill's “iron curtain” speech. But President George Bush's speech in Washington, DC, on February 26th had something in common with those history-making pronouncements. It embraced a role-defining ambition for America and (as he put it) “the civilised world”: the transformation of the Middle East.

While other countries debate the next stage in the countdown to war in Iraq, Mr Bush is pushing America to debate not merely what happens in Iraq after Saddam Hussein's fall, but the ramifications of that event throughout the region over decades. In his speech to the American Enterprise Institute, a conservative think-tank, Mr Bush took what is almost the boldest possible position on the three big questions raised by a post-Saddam settlement.

For the past few weeks, the administration has been debating two approaches to governing Iraq itself after Saddam Hussein. One, urged by the Iraqi opposition and Paul Wolfowitz, the deputy defence secretary, calls for the rapid establishment of a democratic system under a federal constitution. The other, more sceptical about prospects for democracy, proposes a longer transitional administration, perhaps run by the United Nations.

These two approaches are not exclusive and Mr Bush did not rule out the second. Indeed, the Pentagon is setting up an Office of Reconstruction and Humanitarian Assistance under a retired general, Jay Garner, which would work with—or perhaps even form—the transitional administration. But Mr Bush made clear where his preferences lie: “There was a time when many said that the cultures of Japan and Germany were incapable of sustaining democratic values. Well, they were wrong. Some say the same of Iraq today. They are mistaken. The nation of Iraq...is fully capable of moving towards democracy.”

A democratic Iraq is only the start of Mr Bush's ambition. After the last Gulf war, his father used America's increased prestige to convene the Madrid conference, which led to the Oslo peace process. In his speech, the son for the first time linked victory in Iraq to a renewed effort in the Middle East. “Success in Iraq”, he argued, “could begin a new stage for Middle Eastern peace, and set in motion

progress towards a truly democratic Palestinian state.” This is something that Tony Blair has been urging on him from the start.

In June, Mr Bush called for an independent Palestine by 2005, provided the Palestinians acquired democratic leaders. In this speech he dwelt on the exemplary impact the fall of Mr Hussein might have in Palestine. “Palestinians who are working for reform and long for democracy will be in a better position to choose new leaders.” Still, this is the first time Mr Bush has publicly espoused the view that the road to Jerusalem leads through Baghdad. And he added a demand that “as progress is made toward peace, [Israeli] settlement activity in occupied territories must end.”

But the most ambitious part of Mr Bush's speech was his argument that “a new regime in Iraq would serve as a dramatic and inspiring example of freedom for other nations in the region.” Sceptics in the State Department, Europe and the region itself worry that an American invasion of Iraq would increase anti-Americanism, boost Islamic fundamentalists and force authoritarian regimes to crack down on critics, rather than experiment with political reform. Mr Bush called pessimism about the Arab propensity to democracy “presumptuous and insulting”.

Of course, Mr Bush may be wrong. He may also risk putting America's relations with Saudi Arabia and other Arab regimes under greater strain. But no one could accuse Mr Bush of lacking ambition. His speech would—if translated into detailed policy—commit America to a course of seeking a Middle Eastern transformation that would engage his country, and the world, for decades.

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Budget woes in the states

A desperate gamble

Feb 27th 2003 | DOVER, DELAWARE
From The Economist print edition

Stuck in their worst fiscal crisis for 50 years, many state governments hope slot machines will bail them out

THE lights flash, the reels spin, and suddenly the Jackpot Party slot machine starts spewing quarters. With an expert touch, Doris Bowman scoops them by the handful into her plastic beaker. It has been a good morning for the pensioner from Pennsylvania. She has won $140 in nickels and quarters, and it is not yet noon. Roughly once a month Mrs Bowman and her husband get up at 5am and drive more than two hours from their home in Pennsylvania to the Dover Downs slot arcade in Delaware. “We don't come down to get rich” she says, “It's a day out.”

And so it is for the hundreds of punters, mainly older women, who patronise the 2,000 video-slot machines at the Dover Downs racecourse. They sit for hours, feeding bills to machines called “Jackpot Stampede” or “Texas Tea” (which promises a “Big Oil Bonus”). Sometimes their husbands are upstairs betting on the horses. Mostly, the punters come only for the slots. Mrs Bowman spends a “little over $100” each time. Others spend much more.

From Maine to Florida, America's cash-strapped state governors are looking to get their hands on some of this money. More than a quarter of all states hope to introduce, or expand, these slots at the races—or “racinos” as industry insiders call them—as a way to boost their empty coffers. States receive a one-time licensing fee from the race-course operators as well as a big share of the slots' proceeds. And that can mean a lot. Bob Ehrlich, Maryland's governor, reckons that introducing 10,500 slots at the state's four racecourses will net the state government over $800m a year. (Maryland's estimated budget shortfall next year is a record $1.3 billion.)

The states are in their worst fiscal mess for half a century. The slowing economy and the collapse of the stock-market bubble have hit their revenues hard, while health-care costs have soared. Since America's states, with the exception of Vermont, are not allowed to run deficits, any projected shortfalls must be covered by rainy-day funds built up in boom years, or plugged with tax rises or spending cuts. They are allowed to borrow for investment projects, such as school or road construction, so they have some flexibility. This borrowing has tripled since 1999.

According to the National Conference of State Legislatures (NCSL), the states have already tightened their general budgets for fiscal year 2003, which for most states ends in June, by $50 billion or around 10%. Yet the shortfall is now $26 billion, having jumped 50% in the past two months. For fiscal 2004, the shortfall may be as high as $80 billion. California alone expects a $26 billion hole to plug. Only three states—New Mexico, Arkansas and Wyoming—expect their books to balance next year.

As rainy-day funds run dry, states are facing increasingly tough decisions. Almost 30 states have already introduced across-the-board spending cuts. And more are likely, particularly in health care, education and prisons. The cost-cutting plans range from releasing prisoners early (Kentucky) to cutting the school year by a month (Oregon). Twenty-four states, of which 13 have Republican governors, are considering higher taxes, mainly on cigarettes and alcohol. In this depressing environment slots promise fiscal nirvana: more revenue without raising taxes.

That allure may prove misplaced. Put aside the fact that slot machines are a highly regressive form of taxation (since gamblers tend to be poorer than average). Ignore the costs they create, such as treating gambling addiction. Even considered strictly as a revenue-raising measure, the proliferation of slots may bring states less money than they are hoping for.

Much of the cash will simply be diverted between states, in an increasingly fierce battle for gambling

dollars. Pennsylvania, for instance, is keen to introduce slots to stop Delaware taking Mrs Bowman's dollars. West Virginia, which already allows slots, has threatened to bring in full casinos at its racecourses to keep the punters from Pennsylvania and Maryland coming. Moreover, as the number of racinos rises around the country, competition will eventually erode the industry's monopoly profits and thus the states' ability to extract taxes.

But what else can a cash-strapped governor do? Most of them have promised at some time not to raise taxes. Spending cuts are always politically painful, and the states' appeals for federal help have largely fallen on deaf ears.

Even though this year's fiscal tightening at the state level will cancel out a hefty chunk of his own planned federal fiscal stimulus, George Bush has refused a big bailout for the states. He told the country's governors, assembled for a big meeting in Washington, DC, this week, that in effect they needed to deal with their problems themselves. Privately, administration officials have little sympathy for the states' plight, arguing that many went on an unsustainable spending binge in the 1990s.

Who dealt the cards?

In part, that criticism is fair. According to an analysis from the Cato Institute, spending from the states' general funds rose at an average of 5.7% a year between 1990 and 2001, twice as fast as the rate of inflation and faster even than the rise in federal-government spending. From education to health care for poor Americans, the states expanded programmes and broadened eligibility, even while they introduced big tax cuts.

The states' imprudence, however, does not explain all the current mess. Some of the blame also lies squarely with Uncle Sam. From homeland security to education, Washington, DC, has a propensity to order states to provide services, but then not pay them to do so. For instance, the federal government is supposed to pay 40% of the costs of education for children with special needs. In fact, it pays only 17%, leaving states to shoulder the rest. The states claim that Mr Bush is pulling off a similar fiddle with his landmark “No child left behind” education bill.

If the federal government coughed up its due in all these areas, the states would get an extra $20 billion this year. Not surprisingly, that is where the governors are concentrating their lobbying.

In the long-term, however, the states' fiscal health demands more radical measures. In particular, it means an overhaul of Medicaid, the health-insurance scheme for America's poor that is jointly paid by the states and the federal government. Medicaid is already the states' fastest-growing expense. With health-care costs soaring and the population ageing, that will only get worse.

The White House, to its credit, recognises the need to tackle Medicaid. This year's budget contains some quite radical proposals, mainly to devolve responsibility for the programme to the states. So far, it has drawn a lukewarm reception from the governors, who have also notably failed to come up with many ideas of their own. And that is a pity. For Medicaid reform is a much better route to fiscal health than hoping for a big win on the slots.

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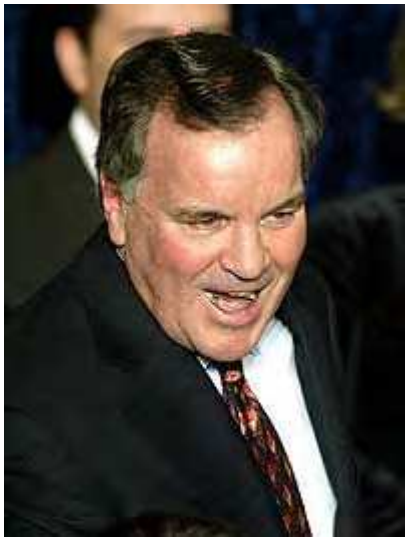
The Daley dynasty

The city with a royal taste

Feb 27th 2003 | CHICAGO
From The Economist print edition

Young Richard holds on to dad's job, yet again. But problems are brewing

AP



The dauphin has become the king

IF THEY don't have grey hair, Americans can be forgiven for thinking a Daley has always been the mayor of Chicago. The formidable Richard J. Daley ruled America's third-largest city with an iron fist for 21 years until his death in 1976, in the process creating his famous Democratic machine. This week the machine brought his son, the almost synonymous Richard M. Daley, rolling quietly into his own fifth term as mayor in an election that felt more like a coronation.

But today's Daley runs a different city from the one his father gripped (though he still uses some of the old man's tactics). Twenty years ago the younger Mr Daley, in his first bid for the city's top job, lost a racially envenomed election to Harold Washington, who became the city's first black mayor. In those days Chicago was still stinging from the racial antagonism of the 1960s. It was only after Mr Washington's death that young Richard M. took office, in a special election in 1989.

Since then he has won a growing share of votes at each election. His overwhelming victory on February 25th—he won 79% of the admittedly few votes cast—had been seen as a foregone conclusion for months. The City Council generally rubber-stamps the mayor's proposals. And now that Chicago Democrats hold all but one of Illinois's top state offices, Mr Daley's reach extends far beyond the city itself. This is a man who is used to getting his way.

So far, Mr Daley's way seems to be working. How much Chicago has changed in the past 20 years was shown by what happened—or did not happen—after the disaster in a city-centre nightclub on February 17th, when 21 young people, all of them black, died in a stampede after the club's bouncers used pepper-spray to break up a fight. Although some black leaders, including Jesse Jackson, blamed the city authorities for not having supervised the club properly, the race riot that might once have been expected never occurred. For the moment, the mayor seems to have the approval of the city's blacks—even though some of their leaders grumble about the Daley machine's power.

Most Chicagoans think that Mr Daley has done a decent job. The city centre is cleaner, greener and more vibrant than ever before. The public schools, though still worse than they ought to be, have shown signs of improvement since Mr Daley took them under his own control in 1995. Tourist attractions such as the redesigned Museum Campus and the polished-up Navy Pier, which gets 9m visitors a year, have opened up on Mr Daley's watch. Many residential areas have been reinvigorated by immigrants from Latin America, eastern Europe and Asia.

As elsewhere, though, the economy throws a shadow over all this. For most of his time in office the mayor has had the benefit of a prosperous Chicago. Now the city faces its toughest time since he took office. Chicago lost more jobs last year than any other big American city except New York, as companies ranging from the giant Arthur Andersen to side-street firms shed thousands of workers. Middle-class parents still move out of the city into the suburbs when their children reach school-age because they mistrust Chicago's public schools. And in dealing with all this Mr Daley cannot expect much help from the state, which has its own budget woes.

The city has one of the country's highest murder rates, largely because of drug dealing and gang warfare in poor areas. Public housing is being torn down faster than new units of affordable housing can be built.

Even on the beautification front, Mr Daley has his critics. Millennium Park, intended to be a showcase of green space and culture, has run wildly over budget and behind schedule. And Soldier Field, home of the Chicago Bears football team, is turning into an eyesore alongside Lake Michigan as something that looks like a huge flying saucer has appeared among its venerable columns, in a “renovation” the mayor backed despite fierce opposition from many quarters.

There are opportunities ahead, to be sure. A Daley-backed plan for the expansion of O'Hare airport, though not yet problem-free, has moved forward since Republican opposition to it crumbled after the Democrats' near-sweep in state elections. As the region's population goes on growing, several plans for improving its infrastructure have emerged, ranging from a central-area project developed by the city's planners to a more ambitious regional scheme that comes from a group called Metropolis 2020. The plans illustrate the choices Chicago and its suburbs face on issues ranging from roads and public transport to open-space planning.

Given the mayor's admiration for Paris, a sister-city of Chicago, and his penchant for borrowing ideas from the French, such grand projects are perhaps not surprising. Nor is his taste for wrought-iron fencing and some controversial French-built bus shelters. As Jacques Chirac has demonstrated lately, France's leaders also tend to plough ahead regardless. But the icy reality of Chicago's winters will stop one French idea from crossing the Atlantic. The sandy beach with palm trees that opened along the Seine last year is unlikely to be imitated along the banks of the Chicago River.

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Forcible medication

A new insanity defence

Feb 27th 2003
From The Economist print edition

Can you treat an insane man just so that you can convict or execute him?

AP

Singleton, mad but alive

WHEN it became known some 30 years ago that authorities in the Soviet Union were forcing imprisoned dissidents to take powerful drugs under the guise of treating them for mental illness, Americans condemned such behaviour as barbarous. Next week, the Supreme Court will hear oral arguments in a case that centres on whether an insane defendant can be forcibly medicated to make him competent to stand trial. And making its way towards the court is another case with an even starker question: should an insane man be forcibly doped to make him sane enough to be executed?

Over the past three decades, drugging awkward people against their will has become an increasingly common practice in America as psychiatrists have come to rely on pills, rather than the couch, to treat a growing array of mental illnesses. That does not make it uncontroversial.

The case that reaches the court next week concerns Charles Sell, a dentist from Missouri with a history of mental illness. In 1997 Mr Sell and his wife were charged with Medicaid and insurance fraud arising from his dentistry practice. Since then, his condition has deteriorated. At one court hearing he lost control, screaming racial abuse and spitting in the face of the judge. He then allegedly tried to hire a hit man to kill both a former employee who was planning to testify against him and the FBI agent investigating his case. He has since also been charged with attempted murder.

In 1999, a federal court found that Mr Sell was no longer sane enough to be put on trial. In a series of subsequent court hearings and appeals, judges first confined him to a prison hospital and then agreed with the hospital's medical staff that he should be forcibly given antipsychotic drugs for his own safety. Mr Sell and his lawyers have fought against this. He succeeded in having the safety issue put aside, but in 2002 the federal appeals court in St Louis ruled that he could be forcibly doped solely to make him competent to stand trial on the original fraud charges. He appealed to the Supreme Court, claiming that forcing him to take the drugs would breach his rights under the first, fifth and sixth amendments of the constitution.

Libertarian groups have taken up Mr Sell's case as an example of outrageously aggressive government meddling, with one neatly trumpeting it as the "*Roe v Wade* of the mind". Mr Sell's brief to the Supreme Court follows this line of argument, making broad claims that the government's efforts to inject him with mind-altering drugs is such a breach of his rights to liberty, bodily integrity, freedom of thought, personal autonomy and privacy that it should not be allowed.

In fact, the justices are likely to decide the case on much narrower grounds. In a 1990 case the Supreme Court ruled that a mentally ill prisoner could be treated with antipsychotic drugs against his will, but only if doctors thought that without the drugs the prisoner was a danger to himself and others. But the court may now be willing to go further. In 2001 it let stand, without comment, a lower-court decision to allow the forcible medication of Russell Weston, a schizophrenic who shot dead two police officers in the Capitol in 1998, so that he could be put on trial.

The federal government's lawyers concede that in Mr Sell's case prosecutors must prove three things: that forcibly medicating him will probably restore him to mental competence; that the side-effects will

not be too onerous; and that there is no less-intrusive alternative. If these safeguards are observed, however, the government argues that the public interest in prosecuting serious felonies such as fraud (the murder charges are not included in the appeal) should outweigh Mr Sell's right to refuse the medication.

An equally pressing conflict between individual and collective rights is presented by another case from the same appeals court. It ruled last month, in a bitterly divided 6-5 decision, that prison officials in Arkansas could force Charles Singleton, a prisoner on death row who has become psychotic, to take medication to make him sane enough to be executed.

It may seem difficult to believe, but the Supreme Court has never ruled explicitly on this issue. In a 1986 case it said that prisoners so insane that they could not understand the punishment they were about to suffer or why they were being punished could not be executed. And it has also ruled that prisoners can be forcibly medicated in their own interest. But these two rulings fit together awkwardly. Is it ever in the interest of a prisoner to be forced to take drugs that may, temporarily, make him sane enough to be executed? And would any doctor administering those drugs be breaking the Hippocratic oath?

The issue may be an ethical hot potato, but it is far from academic. Medication, both forced and voluntary, is widespread throughout America's prison system. Many of those on death row suffer from serious mental illness, and some of these are on medication. The court's critics claim that, in reality, it has often turned a blind eye to the execution of the insane simply by refusing to hear their appeals. Mr Singleton's lawyer is about to file his appeal. Will the court agree to hear it?

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Lexington

Enough, children

Feb 27th 2003
From The Economist print edition

American anti-Europeanism does less damage than European anti-Americanism. But it is still worrying

THE spoof Google search doing the rounds in Washington, DC, runs: “Your search—French military victories—did not match any documents. No pages were found. Did you mean French military defeats?” An affable Frenchman might merely find it odd that Napoleon is unknown in America, despite selling a chunk of it to Jefferson, but other barbs will hurt. “What do you call a Frenchman advancing on Baghdad?”“A salesman.” On American talk shows, it is open season on continental Europeans, especially those “cheese-eating surrender monkeys”.

Politicians seem to have caught the tabloid spirit. “I am particularly disgusted”, thunders a California congressman, “by the blind intransigence and utter ingratitude of France, Germany and Belgium. The failure of these states to honour their commitments is beneath contempt.” Richard Perle, a Republican hawk, now says that France should no longer be considered an ally. The speaker of the House mutters about boycotting Beaujolais.

Now, as is the nature of these debates, people are trying to argue that it is overdone. Stanley Hoffman, a Harvard professor, dubs the outbreak “one more episode in a long history of disagreements”, albeit a bit worse than usual. Taking to task a long piece on anti-Europeanism in the *New York Review of Books*, Gerard Baker of the *Financial Times* argues that most Americans do not care enough about Europe to be anti-European.

So how furious are the Americans? Certainly, American anti-Europeanism is a marginal phenomenon in comparison with its evil European twin. A (real) Google search generates 401 references to “anti-Europeanism in America” and 22,300 to “anti-Americanism in Europe”. Americans do not march in their millions against the policies of the French or German governments. They do not set fire to bistros or establish academies to protect their cultural patrimony. European culture is welcomed as elegant, or derided as snobbish; it is not feared (though perhaps it should be: most of the trashiest American “reality TV” shows originated on the continent of Shakespeare and Rembrandt).

Self-assurance is often the difference. Americans do not define themselves in opposition to Europe, as Europeans sometimes do to the United States. American capitalism is not the alternative to the European social market. America, to its inhabitants at least, is just America, the city on the hill. Opinion polls show

that Americans are more patriotic than most Europeans, and alongside that patriotism goes a sense of superiority. We're the best. Europeans are not so lucky, but neither are Canadians, Mexicans or anyone else. This self-confidence takes some of the edge off American hostility, just as it sharpens Europe's.

Moreover, there has always been an undercurrent of American hostility towards Europe—or at least some European countries—which coexists with friendlier feelings and which should make the current spate of derision less of a shock. Some of it is ethnic-based. Irish-Americans long disliked their country's “special relationship” with Britain. There is also a streak of isolationism. Americans are rightly proud of thrice helping to rescue Europe from its suicidal follies—but, in both hot and cold wars, American governments had to overcome popular reluctance to get involved.

This undercurrent is not specifically anti-European, though. America does not have a long intellectual history of anti-Europeanism comparable to, say, the anti-American tradition in France. It is hard to imagine the American bestseller list boasting titles like “The Anti-European Obsession” or “The European Enemy”, as France's has. America does not fear France or Germany as it feared the Soviet Union 25 years ago; or even as it feared Japan (in industrial terms) 15 years ago; or as it may yet fear China.

All this makes American anti-Europeanism different in scope from its opposite across the pond. It is more marginal, indifferent and shallow. But that does not make it irrelevant. At a time when many Americans and Europeans disagree about basic strategic assumptions, the current vitriol is disturbing. Opinion polls show a sharp drop in American fellow-feeling to Europeans in general and the French in particular. That can be put down to the quarrel over Iraq. But the polls also show a more gradual decline in Americans' perception of their “vital interest” in Europe, and this trend may prove harder to reverse.

Burger-eating war monkeys

The most dangerous part of America's anti-Europeanism, just like its mirror-image in Europe, is its willingness to ignore specific facts for the sake of a good stereotype. “The current stereotype of Europeans”, writes Robert Kagan in his new book, “Of Paradise and Power”, “is easily summarised. Europeans are wimps.” Which is all very well—except that half the members of the European Union and almost all the applicant members support a tougher line on Iraq than France and Germany do. European peacekeepers hold the Balkans together and form much of the Afghan peacekeeping force. Those cowardly French, like the rest of NATO, invoked Article Five, offering military help to America after September 11th.

More to the point, the Bush administration shares some of the blame for the emerging caricature. Donald Rumsfeld's crack about “Old Europe” contained at least a kernel of truth, but, like lumping Germany with Libya and Cuba, it pandered to a stereotype. The White House has done little to restrain vociferous chaps like Mr Perle from hammering the French on a daily basis. Naturally, Mr Bush's people will claim that the Germans started it (by running an anti-American election campaign). And American resentment is a reaction to anti-Americanism. But that misses the point. America is the only possible leader of a western alliance. The more the White House stoops to the playground antics of its critics, the more it encourages them. From a true leader, a little effortless superiority is called for.

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Mexico, the United States and Iraq

Time to be counted

Feb 27th 2003 | MEXICO CITY
From The Economist print edition

AP

A horribly difficult moment for Vicente Fox and his country

Get article background

WHEN it won its non-permanent seat on the United Nations Security Council, Mexico never thought it would come to this. Over the next two weeks, as the debate over the second resolution on Iraq is played out in New York, it has to take perhaps the most difficult diplomatic decision it has ever made: whether to support the resolution, as America demands, abstain, or vote against.

Mexico's position is trickier than any other member's. On the one hand, it has actively sought in recent years to become America's best partner and friend. Back in 2001, which now seems a painfully long time ago, President George Bush famously remarked that America had “no closer relationship”. Why, his *amigo* President Vicente Fox, in his boots and jeans, was obviously a closet Texan.

On the other hand comes the tug of old Mexico: a country with a strong history of non-interventionism, even isolationism, mixed with what many Mexicans like to think of as a tradition of pacifism, especially in foreign affairs. After weeks of toing and froing, Mr Fox's government must now show where it stands.

The American connection is all-consuming. The two countries celebrate the tenth anniversary of the North American Free-Trade Agreement (NAFTA) this year, which has linked Mexico umbilically to its neighbour. Almost 90% of its exports go to America. About 20m people of Mexican descent live in America, more than a fifth of Mexico's own population. America bailed out Mexico when the peso collapsed in 1995. Why on earth, ask many Americans, should Mexico think twice about supporting America now?

When Mexico sought a Security Council seat in 2001, as part of Mr Fox's new strategy of playing a role on the world stage, America naturally endorsed the idea. Now, in Mr Bush's view, it is time to live up to those new responsibilities. He is exasperated by Mexico's lack of support, as he made clear last Saturday in a blunt phone call to Mr Fox. An abstention will not do, either. In the words of one American official, “An abstention is a failure to step up to the plate and play the game.”

But the exasperation is not all one-way. One of the great ambitions of Mr Fox's government, elected in 2000, was to get a comprehensive immigration accord with the United States, protecting the rights of an estimated 3m-5m illegal immigrants in America. This was always going to be an uphill task, but after September 11th 2001, when America began to distrust all brown-skinned incomers, talks on such an

agreement stalled completely. The resulting resentment and frustration in Mexico have fed into the lack of sympathy for America over Iraq.

In a poll last week for Consulta Mitofsky, 79% of those asked thought that Mexico should not support America. Mr Fox, who faces vital congressional elections in July, reads such figures keenly. Some foreign-policy experts, such as Jorge Montaño, Mexico's ambassador to the UN during the last Gulf war, fear that the president's “macho statements” against the war have boxed him in: unable to consider the second resolution on its merits, he will simply have to abstain.

However, the Americans are confident that it will not come to that. The administration is not doing anything so vulgar as putting cash on the table, as in the case of Turkey. But it is reminding Mexico of the possible effects if it fails to come through. A stream of American officials, sounding much more hostile than sorry, have been trekking south to argue the point. Most of the pressure, though, is coming from the grass-roots. Rogelio Ramírez de la O, an independent Mexican economist, argues that American boardrooms are discussing whether to cut back future investment in Mexico if the Mexicans disappoint them. One American diplomat has given warning that a Mexican No could “stir up feelings” against Mexicans in the United States. He draws comparisons with the Japanese-Americans who were interned after 1941, and wonders whether Mexico “wants to stir the fires of jingoism during a war”.

The Americans note that Mr Fox, for all his political posturing and his genuine moral difficulties (as a firm Catholic, he can hardly ignore what the pope is saying about war and peace), has always left himself some wriggle-room. On February 25th he seemed to make his strongest statement so far against Iraq, arguing that “the world wants peace, but only the disarmament of the Iraqis can assure that peace.”

If Mr Fox is going to accept the logic of his vaunted position as America's closest ally, there will be no option in the end but to vote with America. But he had better start making the case very soon. With public opinion so unprepared, a Yes vote could do him and his party great short-term damage. It might also earn him a longer-term reputation for leadership.

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Venezuela

Absent friends

Feb 27th 2003 | CARACAS
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Two bombings reveal both timidity and confusion

Get article background

CESAR GAVIRIA, the long-suffering secretary-general of the Organisation of American States (OAS), has laboured mightily over the past few months to achieve a negotiated settlement of Venezuela's political crisis. On February 18th, his labours brought forth a mouse: a timid, eight-point agreement by government and opposition to repudiate violence (including violent language) and discuss disarming civilians. Within a week, the mouse was on life-support.

Even as the agreement was being discussed, on the 16th, three soldiers involved in a four-month-old protest led by senior officers in a Caracas square were kidnapped, tortured and murdered, along with a young female companion. A teenage girl was also left for dead, but survived. Police investigators hinted at an improbable-sounding private revenge-killing; the opposition blamed the government.

On February 19th, Mr Gaviria left Caracas for a week: that night, secret-police agents and military-intelligence officers arrested Carlos Fernandez, an opposition leader, at gunpoint as he left a restaurant. They put him behind bars on charges ranging from treason to criminal conspiracy, at the instigation of a judge and prosecutor with obvious links to the government.

The OAS chief tut-tutted, calling on the authorities to ensure an impartial trial. Other governments, including the United States and Spain, also expressed concern. This earned them an extraordinary tirade from President Hugo Chávez on his self-indulgent weekly television and radio show. Almost beside himself with irritation, he told them all to mind their own business.

Thirty-six hours later, on February 25th as Mr Gaviria was about to return, two powerful bombs were detonated near the Spanish embassy and outside the Colombian consulate. Leaflets of dubious provenance attributed the attack—the first of its kind in Venezuela—to pro-Chávez radicals angry at foreign interference. Whatever the truth, the group responsible clearly had access to plastic explosives, professional bomb-making expertise and a nice laser-printer. No one died, but only because it was very early in the morning.

The international diplomatic community has been conspicuous largely by its absence since the creation in January of a “group of friends”—Spain, Chile, Mexico, Brazil, Portugal and the United States—whom Mr Chávez regards as mostly unfriendly. So does the president want to irritate them and cause the talks to collapse? Or are radical opposition groups determined to promote international intervention? Probably, and possibly.

The opposition seems increasingly bereft of plausible strategies and riven by internal dissent, despite gathering millions of signatures favouring some form of early election—which Mr Chávez seems determined to avoid. But the burgeoning economic crisis is assuming a life of its own. The foreign-exchange markets have been closed for more than a month. Petrol and raw materials for industry are in extremely short supply. Unemployment and inflation are set to rise sharply, and GDP is on the verge of an unprecedented collapse.

The impact of all this at street level can only be guessed at. Many in opposition fear that the impending conflict in Iraq will act as a kind of solar eclipse, during which, while the world is distracted, Mr Chávez may well fulfil his promise of a “revolutionary offensive”. If he does, Venezuela will need all the friends it can get.

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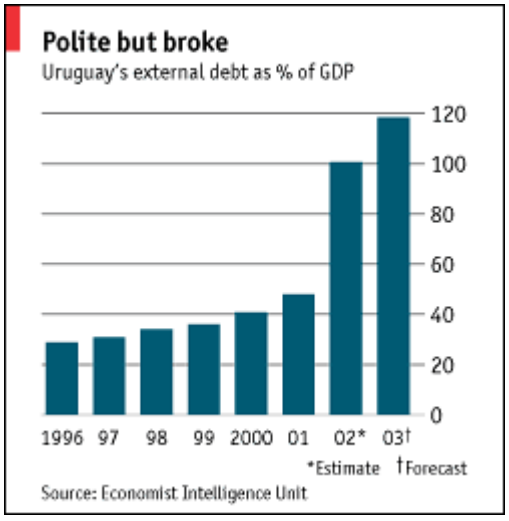
Uruguay

The good debtor

Feb 27th 2003 | MONTEVIDEO
From The Economist print edition

A struggle against time to avoid default



"WHAT the IMF is proposing has nothing to do with Uruguayan reality," rasps Alberto Couriel, a senator for the opposition Frente Amplio (Broad Front). A typical leftist rant? Not quite. "We cannot and should not declare a debt default," Mr Couriel goes on. "Uruguay has always been a good payer."

In December 2001, Argentina's leaders proclaimed default as if it were a political triumph; since then, its neighbour Uruguay has waged a desperate struggle to continue to service its debts. But many investors and, it is said, the IMF believe default to be inevitable. Is the difference between Uruguay and Argentina simply a responsible left, and better manners?

With only 3.5m people, Uruguay has been an accidental victim of its larger neighbour's economic collapse. Last year, not only did Argentines stop buying Uruguay's goods and visiting its beaches, but they pulled their money from the traditional bolt-hole across the River Plate. Uruguay's foreign reserves fell by $200m a month, the peso collapsed and so did four local banks. At last, in August, the IMF, egged on by the United States Treasury, stepped in with a $3.8 billion loan.

That calmed matters. Deposits have trickled back to the banks and the peso, having lost half its value in the first half of last year, has stabilised. But the damage had been done: GDP shrank by 10.5% last year, unemployment climbed to 20% and the burden of the public debt, all of which is in dollars, has doubled (see chart). To avoid default, President Jorge Batlle's government is trying to impose a fiscal squeeze. This involves great hardship. In egalitarian Uruguay, the state pays the wages or pensions of 1m people; this takes 62% of government spending. By law, civil servants cannot be sacked. So the adjustment has come through inflation. In real terms, average wages fell by 11% last year.

Even so, it was not enough. On February 21st, the government said that it had agreed on softer fiscal targets with the IMF. This year it will aim for a primary fiscal surplus (before interest payments) of around 3.3% of GDP, rather than 4%. In due course, Uruguay will also seek a "voluntary" restructuring of some of its debt.

Technically, that would amount to default. But if it happens in ways "that are not seen as discriminating and punitive to creditors, Uruguay will not be unduly penalised," hopes Ernesto Talvi of CERES, an economic research institute in Montevideo. The government hopes that a regional recovery may make such a step unnecessary, but investors are nervous. The "risk premium" on Uruguay's bonds rose (to 21.3%) after the announcement.

Mr Batlle was greeted by pot-banging protesters last week, a rare event in a country that respects its leaders. But nobody wants to overthrow the government. The Frente Amplio, which closely resembles the Workers' Party of Brazil's Lula, has its sights on a presidential election due in November 2004. "If the Frente follows Lula and goes to the centre, it will win easily. That means showing Uruguayans that it doesn't stand for chaos," says Adolfo Garce, a political scientist at the University of the Republic. So, rather than organising strikes and protests, Tabaré Vázquez, the Frente's leader, has been to Washington to meet the IMF. Uruguay's economy may be in a sad mess, but its democracy is showing exemplary maturity.

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Colombia

Prisoners of the FARC

Feb 27th 2003 | BOGOTA
From The Economist print edition

Suddenly, gringos are in the front line of Colombia's civil war

AP

What were they up to?

Get article background

AMERICANS on official business used to feel fairly safe in Colombia. Despite their country's growing involvement there, helping President Álvaro Uribe's government to fight the country's largest rebel group, the FARC, they had managed to avoid the rebels' sights. No longer. On February 22nd, the FARC admitted that it had seized three Americans as hostages after their small aircraft had crashed nine days before in hostile territory in southern Colombia. Another American and a Colombian army sergeant, also on board, had already been found shot dead.

What these men were up to is still unclear. The FARC, a Marxist movement, claims that they were from the CIA, and that it shot the aircraft down; the American government says they were working for a contractor to the Pentagon, and that the aircraft had to make an emergency landing. Either way, the dead passengers seem to have been killed by the FARC, and their missing colleagues are the first Americans known to have ended up in rebel hands while on a government job.

As such, they appear to be a prize catch for the FARC, which has long declared rhetorical war on the gringos and has already—according to the United States— murdered private American citizens, including missionaries. It now plans to hold its “prisoners of war” until Mr Uribe's government agrees to a prisoner exchange, swapping jailed rebels for policemen, soldiers and politicians held in FARC custody. The government is interested, but the two sides are far apart on the details.

Will the United States now deepen its involvement in Colombia? Not yet, apparently. More Americans will be deployed, ostensibly to look for the hostages. But the United States has always been wary of this quagmire, where the 18,000-strong FARC is only one of three illegal groups involved, along with Colombia's armed forces, in a seemingly insoluble civil war. Although America has given $2 billion in mainly military aid to Colombia since 2001 to fight drug-trafficking and has, since last year, allowed this aid to be used against the FARC, Americans have been kept away from the front line. A congressional cap means that, emergencies apart, no more than 400 troops can be deployed. Many of the people working under contract for the State Department, on jobs such as spraying coca with herbicides, are not Americans.

Nor is it clear that the FARC would, or should, want to raise the stakes with the Americans. Daniel García-Peña, a peace commissioner under a previous Colombian government, says the FARC may believe that provoking more American involvement in Colombia could give its cause (increasingly tarnished by

urban bombings) more national legitimacy. But although some Colombian lawmakers have denounced the prospect of more American intervention, most Colombians would probably welcome it. The United States has in any case already helped Colombia with large-scale eradication of drug crops—a policy which, some believe, is starting to squeeze the FARC's purse.

The most likely outcome is that the recent kidnapping will strengthen Colombia's case for more American cash, intelligence and military hardware—all of which could harm, rather than bolster, the FARC. But Congress in Washington may well ask whether Americans in Colombia need better security than they have now.

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Panama

Handy things, canals

Feb 27th 2003 | PANAMA CITY
From The Economist print edition

Especially when you have a big deficit

EVER since the United States handed the Panama Canal back to Panama, more than three years ago, the waterway has worked better and made bigger profits. So well is it doing that the Panamanian government, faced with a mounting budget deficit, has decided to use canal revenue to plug the gap.

Normally speaking, economists would allow this convenient money-shift. Panama says it is doing it under new public-sector accounting practices endorsed by the IMF. But the canal is no ordinary asset. In 1993, during the run-up to the handover, an article was added to the Panamanian constitution to guarantee the autonomy of the new Panama Canal Authority. Under Article 314, the canal's accounting “does not form part of the state's general budget.”

In this young democracy, where civilian rule was not restored until the end of 1989, it was thought wise to keep the canal and the government apart. For the first three years, the government respected the canal's autonomy and kept its hands off the revenue. But with the deficit growing (and with a legal obligation to keep it below 2% of GDP), temptation became too much.

Late last year, the government suddenly came up with figures consolidating the net financial results of the Panama Canal Authority, some $90m, into its own non-financial public-sector accounts. It then backdated the change to 2000-01, as if the failure to consolidate before had been a mere oversight.

By most independent assessments the deficit stands at 3-4% of GDP, double what is permitted. The new accounting methods conveniently reduce it to the 2% that is allowed. Critics add that the government's figures seriously underestimated the deficit anyway, predicating it on wild growth figures of 6-7%, and fail to recognise that spending is bound to soar next year, when there are elections.

Domingo Latorraca, the deputy economy minister, says the canal's independence is intact, but some of those who run it are nervous. The Panama Canal Authority is considering a $5 billion-$8 billion expansion, including the dredging of a new lake and a third set of locks. This, the largest upgrade since the opening of the canal in 1914, will require huge international loans and a healthy credit rating. Panama's own rating is reasonable by Latin American standards—a solid BB—but current economic woes are likely to push it down. The canal, on its own, could expect a far higher rating than that.

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China

Room at the top?

Feb 27th 2003 | BEIJING
From The Economist print edition

The National People's Congress convenes to complete China's leadership changes

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AS CHINA prepares to complete its biggest shuffle of top Communist Party and government posts since the 1970s, one leader's position remains barely changed. Even after he gives up the state presidency at the annual two-week session of the National People's Congress (NPC), which begins on March 5th, Jiang Zemin will still be the country's paramount figure. But his supposed successor, Hu Jintao, may have a card or two to play as he struggles to assert some authority of his own. Whereas Mr Jiang's career has concentrated on nurturing the middle class, Mr Hu presents himself as a champion of the poor.

It is too early to conclude that Mr Hu is deliberately distancing himself from Mr Jiang. It was only in mid-November that he replaced Mr Jiang as the party's general secretary. When Mr Jiang, who is 76, stepped down from the position, he made sure not only that other party elders (whom he saw as potential rivals) retired with him, but also that the newly constituted Politburo was packed with allies.

Lacking supporters in key positions, the 60-year-old Mr Hu would be unwise to challenge Mr Jiang soon. Mr Jiang is all but certain to be reappointed as chairman of the state's Central Military Commission (CMC) at the upcoming parliamentary meeting. Although this position has little meaning—the state CMC exists only on paper—the appointment would indicate that he plans to hang on to his most important job, as chairman of the party's CMC, which makes him the armed forces' supreme commander. The state and party CMCs are normally led by the same man.

When the party's central committee met in November to endorse Mr Hu's appointment as party chief, it also secretly agreed to “respect the advice of party elders” (party code for “obey Mr Jiang”). In the official media, Mr Jiang still receives more prominent coverage than Mr Hu, even though he is no longer in the Politburo. The NPC, China's parliament, is all but certain to promote Mr Hu to the presidency, in succession to Mr Jiang. Yet, since Mr Hu became party chief, there have been no reports of his visiting any military institutions, which suggests that Mr Jiang still guards his power in this field.

But Mr Hu has not been eclipsed. The media have paid considerable attention to his two publicised forays outside the capital since November, both of which were clearly aimed at transforming his image from

colourless apparatchik to caring man of the people. The first visit, in early December, was to Xibaipo, a rural area of Hebei Province, south-west of Beijing, where Mao Zedong and his communist forces based themselves before moving into the capital in 1949.

Xibaipo is a regular destination for leaders seeking to identify themselves with the party's revolutionary origins, but Mr Hu used the occasion to deliver a speech in which he mentioned the need for “hard struggle” and “plain living” more than 60 times. Then, in early January, he went to the frozen grasslands of Inner Mongolia, where he sat in a herder's tent and spoke of the need to help the poor and unemployed. “Hu Jintao is aiming to get the support of ordinary people,” says one academic.

Mr Hu's example has brought about a series of copycat visits to historic revolutionary sites and poor parts of the country by officials in many parts of China. At the end of January Wen Jiabao, who is expected to succeed Zhu Rongji as prime minister at the forthcoming parliamentary meeting, went down a 720-metre coal-mine shaft in the bitterly cold north-east to join the mine's workers in celebrating the lunar new year.

So far, at least, Mr Hu seems to have the support of the man widely regarded as his biggest potential rival, Zeng Qinghong. Mr Zeng is a close ally of Mr Jiang's who was promoted to the Politburo's nine-member Standing Committee in November and is likely to acquire the additional title of state vice-president during the parliamentary session. Official newspapers and television tried to dispel rumours of rivalry between the two men by showing them close together during the Xibaipo visit. Playing the public-opinion card may help Mr Hu to keep Mr Zeng in check.

Mr Zeng, who is 63, may in fact turn out to be the party's best hope of reviving the limited political reforms that were abandoned in 1989 after the crushing of the Tiananmen Square protests. In December, Mr Zeng took over from Mr Hu as president of the Central Party School, an academy for top officials. There he is setting up a new research centre for political reform. He has also taken over Mr Hu's responsibility for party-organisation issues such as the selection and promotion of officials, where he is keen to encourage more democratic procedures. Mr Zeng has supported plans by Shenzhen, a port bordering on Hong Kong, to introduce reforms that would curb the party's power to interfere in what the government is doing.

But if Mr Hu wants to win the public approval that Mr Jiang never managed to acquire, he will need to work particularly closely with Wen Jiabao, who as prime minister will be responsible for overseeing economic policy. Mr Wen (currently a deputy prime minister) has considerable experience in financial and agricultural affairs, both areas that are in desperate need of reform if the country is to sustain the high level of growth needed to give work to the unemployed. Mr Wen, it appears, favours more spending on education and health care in the countryside and more vigorous efforts to sort out the banking sector, plagued by bad debts and corruption.

But, with a swelling budget deficit, he will have few resources to play with. And for all the rhetoric that has been gushing out of the mouths of China's new leaders, little is in practice likely to emerge in the way of new plans to tackle the country's widespread corruption and the rapidly widening gap between rich and poor, between urban and rural areas and between the booming coast and backward hinterland. As one Chinese official puts it, “People want more than just words.” Doubtless, they will be disappointed.

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India

The new Templars

Feb 27th 2003 | DELHI
From The Economist print edition

AP

India's fundamentalist Hindus are inching towards their most cherished goal

Get article background

A SEA of saffron robes, some 8,000 Hindu holy men gathered in Delhi last weekend for the congress of the Vishwa Hindu Parishad (VHP), or World Hindu Council. As the speakers whipped up the saddhus, they brandished their tridents, cudgels and axes, blew deafening blasts on their conch shells, and chanted "*Jai shri Ram!*"—victory to Lord Ram, Hinduism's model king and an incarnation of Vishnu, part of its trinity. This week the holy men trudged homewards, disgruntled. Victory had apparently eluded them. They are not alone, however, in thinking that it is within reach.

The first battle is to raise a temple to Ram at his supposed birthplace in the town of Ayodhya, on the site of a 16th-century mosque demolished by a Hindu mob in 1992. Hindus claim that the Moghuls built the mosque on the ruins of an earlier temple marking the birthplace, as part of a sustained policy of replacing Hindu temples with Muslim mosques. The 1992 clash set off one of India's worst bouts of violence between Hindus and the Muslim minority. But for many Hindus it was just one act in a drama that will inevitably end in the building of a glorious temple.

A year ago, a group of Hindus planned to start its construction. A train carriage, carrying some of them home to the state of Gujarat, was set on fire in the town of Godhra and 58 died. Muslims were blamed; 131 were charged this month as terrorists. In the retaliatory pogrom that followed, some 2,000 were killed.

After the 1992 violence, the government took over the land around the site, whose ownership has been disputed in the courts since 1949. After last year's bloodshed, the Supreme Court banned religious activity there. The VHP wants the ruling overturned, and insists the government hand over the surrounding land so that building can start.

The Supreme Court is to consider the matter on March 6th. The government is equivocating. It is led by the Bharatiya Janata Party (BJP), part of the same Hindu-nationalist "family" as the VHP. The VHP argues that the BJP owes its power to the temple campaign, and that it is time it repaid the debt. The BJP seems to agree. The government itself asked the Supreme Court to lift the ban, and its leading members publicly back the temple.

In the meantime, VHP leaders fobbed off the faithful with a sit-in near parliament in Delhi, a promise of nationwide agitation, and a hint that radar evidence now before the courts proves the mosque was built on a temple's ruins. But, even though the top men hope to achieve their aims legally, Paramhans Ramchandra Das, leader of the temple movement, a 93-year-old veteran of 70 years of the struggle, is

unconvinced. He has set a deadline of March 25th for starting the work.

There is also a political timetable. Four small states went to the polls on February 26th, the latest in a series of important votes that culminate in a general election due next year. The BJP won an election in Gujarat in December by pushing a hardline Hindu-nationalist agenda. That has encouraged greater activism over Ayodhya and other “Hindu” issues. More Muslim shrines are in the VHP's sights. There are renewed calls for a national ban on the slaughter of cows, venerated by Hindus, and controversy over the hanging in parliament, on February 26th, of a portrait of Vinayak Savarkar, a pre-independence Hindu-nationalist leader, one of whose followers killed Mahatma Gandhi.

For C.P. Bhambri, author of three books on the BJP, all this is part of a process whereby “majoritarianism is institutionalised”. He sees similarities with the rise of the Nazis. That may be going too far; but the forces restraining the fundamentalists—the BJP's moderates, its coalition partners and opposition state governments—are not putting up much of a fight.

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Americans in the Philippines

Back to the jungle

Feb 27th 2003 | MANILA
From The Economist print edition

New search for terrorists

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SEVEN months after they left, American troops are on their way back to the Philippines. Their task is the same as before: to help the Philippine army wipe out Abu Sayyaf, a gang of a few hundred kidnappers-cum-Muslim-militants on America's list of terrorists. They are unlikely to find the job any easier this time round. The constitution of the Philippines bars foreign troops from fighting on Philippine soil. So during last year's Balikatan exercise, as the deployments are known, the Americans could only "train, advise and assist" their Philippine counterparts. They did sometimes go on patrol, but were allowed to shoot only in self-defence. In the end, American troops opened fire only twice in six months, and one of those times a soldier shot himself in the foot.

During the new Balikatan, Pentagon officials have hinted, American troops will be much more active, and may even get directly involved in combat operations. The Philippine press pounced on this, accusing America of riding roughshod over the country's constitution. Many Filipinos are still bitter about the period of America's colonial rule, and consider the decision to close America's bases in the country in 1991 a triumph. The Senate has launched two inquiries into the Balikatan exercise.

Nonetheless, the government will probably press on with the deployment, perhaps as early as March. After all, there are already lots of American troops in the country, taking part in all manner of less contentious exercises. Last year's Balikatan was popular with ordinary Filipinos, if not with Congress. The Supreme Court ruled that it was constitutional.

It was not, however, very effective. Most of Abu Sayyaf's fighters simply decamped from Basilan, the focus of the operation, to other islands in the Sulu archipelago. Only one of the group's top five commanders was killed. Even on Basilan, American officials admit, some Abu Sayyaf fighters remain, hiding in the jungle. Since the first Balikatan operation ended last July, the group has taken more hostages, to make up for those rescued during the exercise. It planted a bomb that killed an American soldier involved in another training exercise in the southern Philippines last October.

This time, the exercise will focus on Jolo and other islands to which Abu Sayyaf's fighters are thought to have fled. Unlike Basilan's, the population of Jolo is purely Muslim, and much more suspicious of both the Philippine army and America. In 1906, American soldiers savagely repressed a rebellion on the island. Local leaders, not all from Abu Sayyaf, have already declared the forthcoming exercise an opportunity for revenge. Jolo's terrain is even less hospitable than densely forested and rugged Basilan. No wonder the Americans plan to deploy more than the 1,300-odd troops they sent on the previous Balikatan, and to leave them longer.

The biggest question is how the new deployment fits into the wider war on terror. Abu Sayyaf has some curious acquaintances. When one of its bombs was being defused, the telephone number of an Iraqi diplomat was found, stored in a mobile telephone that was part of the device. Still, the most alarming terrorist network in the Philippines is probably the more sophisticated Jemaah Islamiah, said by the Indonesian police to have carried out last year's bombing in Bali. American officials argue that any campaign which helps to bring order to Sulu will undermine terrorists of all stripes. True, perhaps; but if last year's Balikatan is anything to go by, it is a painfully slow process.

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New Zealand

One ring to bring them all

Feb 27th 2003
From The Economist print edition

Tolkien's epic success for the Kiwis

Best supporting scenery

NEW ZEALAND is doing its best to cash in on being the nearest place in the real world to Middle Earth, the setting for J.R.R. Tolkien's “The Lord of the Rings”, and it seems to be having a fair degree of success. The number of visitors from North America alone in 2002 was up 9.6% from 2001, to 205,289.

The three films made from Tolkien's book (“The Fellowship of the Ring”, “The Two Towers”, nominated for six Oscars, and “The Return of the King”, to be released at the end of this year) were shot in New Zealand. The rugged South Island has taken a starring role, providing the majestic back-drops for some of the films' most dramatic sequences. But the whole country is feeling the benefits.

Wellington, New Zealand's capital, in the more populous North Island, is the home of Peter Jackson, the director of the trilogy. The town's film industry, thriving on tax breaks and an educated, relatively cheap workforce, is doing so well that it has been dubbed Wellywood. “The Last Samurai”, starring Tom Cruise, with a New Zealand volcano doing its best to look like Mount Fuji, is one of several epics being made there.

The campaign to promote New Zealand as a safe and green destination began soon after the terrorist attacks on the United States. The first of the trilogy was just starting to draw in the crowds. Last December Helen Clark, New Zealand's prime minister, was in New York at the time of the premiere of “The Two Towers”, promoting the charms of her faraway country. Pete Hodgson, the energy minister, is now “Rings” minister as well. A New Zealand website flags up a “Land of the Middle Earth” tour. Te Papa, the country's leading museum, has an exhibition based on the epic.

But not even New Zealand is free from worries about terrorism. This week letters containing cyanide were sent to several embassies. As Tolkien observed in his tales, you cannot escape from the struggle between good and evil.

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Higher education in Japan

Scandal on the campus

Feb 27th 2003 | TOKYO
From The Economist print edition

The neglect of serious study

MANY of the students who applied for admission to Sakata Junior College, a university in Yamagata prefecture, in the north of Japan, were from China. Not all of them intended to study. What they wanted was a visa that allowed them to work in Japan. Hard-up Sakata accepted their tuition fees and turned a blind eye when 60% of its 342 students failed to turn up to do their studies. But when word leaked out to the authorities, Sakata found itself in serious trouble. Damaged by the scandal and on the verge of collapse, it has stopped accepting applications for the next university year, starting in April.

Although Sakata's conduct was inexcusable, it has to be said that neglect of serious study is a feature of other Japanese universities. Passing the examinations to get a university place can be tough in some cases—the so-called “examination hell”—but once a student gets there the next four years may involve very little work. Even at top universities, poor attendance often goes unchecked.

Lectures are monotonous and discussions rare, say critics. Assignments are set, but essays, once handed in, may not find their way back to students. “Even when we put a lot of effort into our reports, it's hard to figure out what the professors think of them as we usually don't get them back,” says Ayako Ito, a fourth-year student at Waseda University. Corporate recruiters complain about the falling quality of university graduates.

Student numbers for each university are fixed by the education ministry. Just as other ministries protect the industries they oversee, so too do the education bureaucrats who superintend almost 700 universities, three-quarters of which are privately run. Like companies struggling to reform, these universities are hampered by rigid labour laws that make it hard to fire incompetent members of the staff.

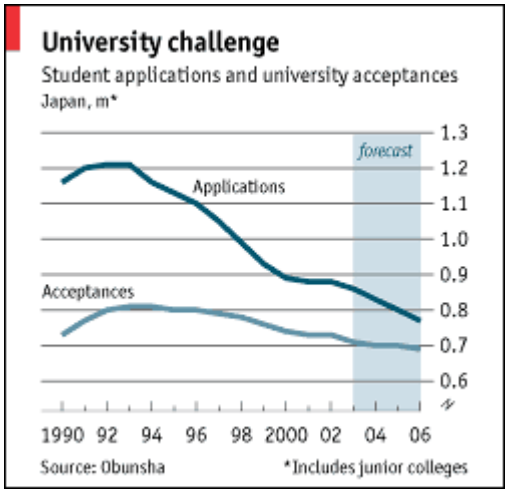
The government provides some money to universities, but the private institutions mostly meet their needs from tuition fees. Once these are paid, says Yutaka Morohoshi, a professor at Obirin University in Tokyo, some universities lose interest in their students. Alumni associations such as those in America and Britain that raise money for universities—and may keep an eye on teaching standards as well—are rare in Japan. Many college administrators do not inspire confidence, lacking even basic managerial skills, such as understanding a balance sheet.

But, says Takafumi Goda, a director in the higher-education bureau at the education ministry, companies need to shoulder some of the blame for falling standards. Their policy has been to seek conscientious graduates who were willing to buckle down and obediently follow orders. But now, he says, Japanese business needs more enterprising folk; they might be able to put pressure on universities to keep up with changing times.

They will have to. Because of Japan's falling birth rate, by 2009, predicts Obunsha, an educational publisher, the number of university applicants will match the number of places offered (see chart). In reality, there will be fewer applicants, since many students opt to take a year off if they do not get into the university of their choice. Mr Morohoshi reckons that as many as one in four universities may not survive the forthcoming era of fierce competition—which will include growing pressure from occupational training schools.

Universities are getting alarmed. Some of the top ones have begun

creating new departments that offer students a broader range of subjects, and more flexible courses. After the Sakata scandal the government says it aims to monitor universities more closely. It is no longer so rigid about curriculums, and hopes that this will persuade universities to start offering innovative new courses. In April next year, it plans to turn public universities into "independent administrative corporations" that have more freedom to spice up courses, hire new professors and engage outside lecturers. From now on, says Mr Goda, universities will have to compete and be more creative if they seriously want to survive.



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North Korea

Don't forget Mr Kim

Feb 27th 2003
From The Economist print edition

As South Korea's new president is sworn in, the North sends a message

IT WAS probably naïve to have hoped that North Korea's leader, Kim Jong Il, would mark the inauguration of South Korea's new president, Roh Moo-hyun, with a friendly gesture. In the event, Mr Kim contrived not one, but two, attempts to overshadow proceedings.

First, just as Mr Roh was actually being sworn in on February 25th, North Korea test-fired a missile into the Sea of Japan. Then, a day later, came news that America had spotted North Korea reactivating its nuclear reactor at Yongbyon. Because the Yongbyon reactor produces plutonium as a by-product (which can in turn be processed into fuel for nuclear bombs), it has been mothballed since 1994 under a deal with America that fell apart last year.

Both of Mr Kim's displays came while Colin Powell, the American secretary of state, was in South Korea, as part of an Asian visit that also took him to China and Japan, where the problem of how to deal with North Korea was high on the agenda. But the Americans seemed determined not to rise to the provocation. The missile, officials pointed out, travelled only a harmless 35 miles (60km) into the sea. It did not come close to replicating the launch in 1998 of a missile which flew over Japan. More provocative by far would be the first testing of North Korea's Taepodong-2 missile, which some analysts believe could reach America's west coast.

Although the reactor start-up is alarming, it is less dangerous than if North Korea reactivated its plutonium reprocessing plant, also located at Yongbyon. It already has a stockpile of some 8,000 spent fuel-rods which, if reprocessed, could yield enough material for five or six nuclear bombs. Running the reactor at Yongbyon can only add to that stockpile slowly.

On the optimistic view, both actions are a (rather undiplomatic) reminder from North Korea that it still wants to talk. The main obstacle, it seems, is working out how. North Korea insists on a bilateral meeting with the Americans, who in turn think this is conceding too much and are offering only bilateral talks within the context of a multilateral meeting of interested parties. That solution is now being promoted by South Korea's new government. It ought not to be impossible to sort a forum out: but talks, of course, are only the start.

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Iraq prepares

A brave face to the fear

Feb 27th 2003 | BAGHDAD
From The Economist print edition

Getty

Iraqis do not love their regime. But war now frightens them more

Get article background

AUDIENCES pack theatre halls, poets pen new collections, and Iraq's National Philharmonic orchestra plays with the dedication of the quartet aboard the *Titanic*. Baghdad is witnessing a cultural revival. “We have to keep busy, always busy,” says a local UN staffer, anxious for projects to keep war from her mind.

In recent weeks a splurge of new art galleries have opened, replete with cafés where writers discuss Voltaire, and actors argue over the patriotism of performing Shakespeare at a time when British battalions are poised to invade. The car-parks buzz with parties, as lovers queue at the steps of hotels to get married, lest next week be too late. Unbowed, the Baghdad Museum this week staged a conference on the renovation of the country's 10,000 archaeological sites. “Good for morale,” say the organisers. A swansong, say others.

The morale-boosting works only up to a point. A midnight thunder-clap makes Baghdadis jump from their beds, panic-struck that the bombardment has already begun. And behind the mask of normality, office clerks fret obsessively over where America's leviathan will stop. Will the Americans, like the Mongols, flatten Baghdad? Or resort to the medieval tactics of a city siege?

Baghdad has had time to prepare. The authorities have distributed food rations four months in advance. Bizarrely in this land of two great rivers, well-diggers and water pumps are Baghdad's latest boom industry. And local community groups have clubbed together to buy generators to provide electricity when the power plants are hit. A UN chief in Baghdad praises Iraq's “wonderful qualities of resilience and courage”. But nobody outside, he adds, is listening to him.

How far will Baghdad resist? Compared with the spirit four months ago, Saddam Hussein now seems less of a menace for most Iraqis than American bombs. The frenzy of pre-war mythology doing the rounds talks of plans for flooding the canals with petrol to form a firewall to hold back the invaders. But for such a militarised state, the activity is strikingly low-key; so far there has been no mass call-up.

Curators at the Baghdad Museum have formed a Dad's Army, under the command of Donny George, the

Falstaff-sized research director at the State Board of Antiquities, uncomfortably squeezed into military fatigues. But he is seriously realistic about the prospects of stopping American missiles, which in 1991 fell at the feet of his herd of mammoth 3,000-year-old Assyrian winged bulls, knocking off toes.

His colleagues have already made for the passport offices, along with a chaotic swarm of families haggling for exit visas to escape. Bus companies report an unexpected interest in the annual pilgrimage to Lady Zeinab, a Shia shrine in Damascus. This is a $32 round trip, equivalent to a teacher's salary for four months. The even more hard-up are rediscovering the extended tribal family, turning to the poorer relatives in Iraqi villages that they had long since preferred to discard. School classes remain full, but at night parents cling to the radios for clues on when to leave before Baghdad raises its drawbridges.

The vast majority, say aid workers, have no resources left and are expected to remain in the cities. To regain some solvency, many middle-class families have cashed in their last asset: their homes. Newly rich smugglers snap up the bargains, fronting the homes of once well-to-do academics with garish neo-Babylonian columns. Keen to transfer their Iraqi dinars into something longer-lasting than a note bearing the face of Saddam, streetwise profiteers open fancy restaurants and buy the latest model Mercedes.

With so much bitterness, and so many guns, Iraqis fear that if central authority breaks down, the wrong surname, not to mention the wrong creed, could cost them their lives. Compounding the sense of abandonment, foreign missions one by one lower their flags and pull out their diplomats. Turkey pulled out this week, but all of Iraq's six neighbours, bar Syria, have battened down the hatches, and vowed to block off the escape routes. Jordan, nourished for 12 years on Iraq's gift of free oil, is now expelling migrants seeking haven.

The mosques and churches are packed with believers seeking a more metaphysical refuge. Do Iraqis see life after death? A brave play opened this week in Baghdad depicting a post-war Iraq in which the daughter of a soldier killed in battle grows up to make a living as a dancer in a seedy night-club. “It represents the American dream for Iraq,” says the playwright, Abdel Khalaq Karim. “When it's all over, what will we think we have lost?”

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Israel's coalition government

Sitting comfortably?

Feb 27th 2003 | JERUSALEM
From The Economist print edition

A coalition that is worry-free for Ariel Sharon, and a worry for everybody else

Get article background

AP

Anti-fundamentalist Lapid

BY LAW and precedent, Ariel Sharon could have dragged out his coalition-building for many more weeks. The pundits thought he would wait for the war on Iraq, hoping that would provide the decimated but still desirable Labour Party a pretext to set aside its reservations, and join him in another government of “national unity”. In the event, he surprised everyone, including his own Likud lieutenants, by whisking up a government majority early this week.

He signed deals with the centrist, stridently secularist Shinui Party (15 seats) and the (right-Orthodox) National Religious Party (6). Together with his own Likud's 40 seats, this made him master of the 120-seat Knesset. A subsequent accord with the even-farther-right National Union Party (7) gives him a comfortable margin, and the luscious prospect of four-and-a-half years of worry-free government.

And he can forget peace talks too

It also pretty much puts paid to the prospect of any serious negotiations with the Palestinians. Mr Sharon has promised the hardline NRP and National Union that any move to resume the peace talks would be put to the full cabinet first, where any such thoughts would presumably be killed. To Shinui he has reiterated his vague acceptance of eventual Palestinian statehood, some time in the future, somewhere in the territories. When the Labour Party leader, Amram Mitzna, tried to pin him down to some here-and-now commitments—to dismantle illegal new settlements, for instance—coalition talks with Labour came to a peremptory end.

Shimon Peres and other would-be Labour ministers criticised the neophyte Mr Mitzna's blunt style; ambiguity, after all, is the essence of coalition trading. But he claims credit for exposing the hollowness of Mr Sharon's talk of “painful concessions for peace”.

The surprise was Mr Sharon's decision to leave out the two ultra-Orthodox parties, Shas (11) and United Torah Judaism (5), both longtime Likud allies, both howling treachery. But he was forced to choose. Shinui's leader, Tommy Lapid, had vowed never to serve in the same cabinet as the ultras, and was not prepared to relent.

Some of the younger Likud leaders were privately aghast at Mr Sharon's choice. They worry that while Shinui's electoral success may prove a flash in the pan, the ultra-Orthodox community, with its high birth-rate and tight inner cohesion, is likely to keep growing. The Likud may well need them next time round. Mr Sharon, 75 this week, will have retired to his ranch by then, leaving his successors the demeaning job of wooing them back.

For now, Mr Sharon was impressed by the strength of the protest against the ultra-Orthodox reflected in the Shinui vote. The party swelled from six seats to 15 on an essentially one-plank platform: an end to ultra-Orthodox draft dodging and living on welfare. Mr Lapid, a journalist and pugnacious television talk-show star—and now the minister of justice—is cursed by ultra rabbis as an “anti-Semite”. But he argues that his proposed reforms would ultimately benefit the ultra-Orthodox themselves, by rescuing them

from their ghettos of poverty and indolence.

Mr Lapid urged a secular coalition of Likud, Labour and his own Shinui. He blames Mr Mitzna for throwing up the opportunity to ram through a broad agenda of liberalising legislation on such vexed issues as sabbath observance and civil marriages. But leaving all the Orthodox parties out of the government, while passing laws “against” them, would have courted social unrest, possibly even violence. Mr Sharon has preferred to defuse the danger by bringing in the NRP, moderate on religious issues though not on Palestine, thereby blurring the battle-lines.

His ideologically disparate partners have had to hammer out compromises of a sort between themselves. Thus, for instance, buses will continue not to run on Saturdays despite Shinui's demand that they do. And Jewish Israelis barred from marrying under religious law can now have their married status registered by the civil authorities, a modest but important erosion in the religious monopoly on marriage and divorce law that the NRP negotiators were forced to swallow.

In a final surprise, one that turned sour on him, Mr Sharon evicted his arch-rival, Binyamin Netanyahu from the foreign ministry, installing instead Silvan Shalom, failed finance minister and loyal supporter. He offered Mr Netanyahu the problem-laden finance ministry, confident that he would refuse. But he accepted.

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Iran's nuclear plans

Suspicions

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The International Atomic Energy Agency's doubts about Iran

Get article background

WHEN Mohamed ElBaradei, head of the International Atomic Energy Agency (IAEA), a nuclear watch-dog, said last week that he was impressed with the “sophistication” of Iran's uranium-enrichment plant at Natanz, the compliment was a barbed one. Though Iran insists that its fast-expanding nuclear plans are entirely peaceful, others have doubts. The United States, said its State Department spokesman recently, has concluded that Iran “is actively working to develop a nuclear-weapons capability.” Such suspicions helped to lead to its inclusion last year, alongside Iraq and North Korea, in George Bush's famous “axis of evil”.

It does not help Iran's case that the world first learned of what was going on at Natanz not from the government, but from the National Council of Resistance, a dissident group that fronts for militants based in Iraq. The group released details of the Natanz plant, and another at Arak for producing heavy water, at a news conference last August. So by letting IAEA officials look around—Mr ElBaradei left two officials in Iran this week to explore further—has Iran scotched the rumours?

No. Mr ElBaradei had first asked to visit the new sites in December but was turned down—to allow time, some say, for a cover-up and for the dismantling of suspect equipment. Iran's president, Muhammad Khatami, has promised to give the IAEA more information, earlier, about future civilian nuclear plans—as other non-nuclear members of the Nuclear Non-Proliferation Treaty already do. But that will not dispel the doubts while Iran refuses to accept toughened inspection rules.

These were drawn up after the Gulf war, when it was learned how close Iraq had come to a bomb without the inspectors knowing. They allow inspectors to go anywhere, not just to places where nuclear materials are admitted to be kept, and to use sophisticated new technologies. Without that freedom, Mr ElBaradei explained, he could provide no more than “limited” assurances of Iran's intentions.

Suspicions of these intensified last month, when Iran announced it would start enriching uranium, and eventually make and reprocess its own nuclear fuel. This would give it access to both enriched uranium and bomb-useable plutonium from its expanding nuclear industry.

It also puts Russia on the spot. It hopes to earn some $1 billion by completing work on a nuclear reactor at Bushehr and building a second one. To allay western fears that the project was a cover for bomb-making, it agreed to provide and take back all the fuel. But Iran has now made clear it will not accept a Russian stranglehold on its nuclear plans.

Meanwhile, Russian companies have long been suspected of supplying Iran with more technology than they have owned up to. Other help of use in a weapons programme is thought to have come in the past from China. Now other countries may have stepped in to help. Iranian officials say that the Natanz plant was built without foreign help. But the suspicious believe that Pakistan provided some of the technological know-how, as it did recently to North Korea.

The sophistication of the Natanz plant will also prompt worries that Iran has been experimenting with uranium-enrichment elsewhere too. The IAEA team is likely to return from Iran with more questions than answers.

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Uganda's politics

Party time?

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From The Economist print edition

Uganda moves towards becoming a multi-party democracy

EPA

My children, you are ready at last

AS AFRICAN presidents go, Yoweri Museveni is considered a great success. When he took charge of Uganda, 17 years ago, the country was a graveyard. Under his predecessors, Milton Obote and Idi Amin, perhaps 800,000 people were slaughtered, and the middle class was driven into exile. Mr Museveni did much to mend matters.

Since he seized power from Mr Obote, Uganda has grown freer, more peaceful, and less poor. Average incomes have risen by an impressive 3.2% each year. A vigorous official campaign against AIDS, combined with a lack of restrictions on private charities, has beaten back the epidemic faster than in any other African country. Western donors, eager for an African success story, have backed Mr Museveni with cascades of cash. The *Times* of London describes him as “a blend physically and philosophically of Nelson Mandela and the late Deng Xiaoping”. Only one thing dampens the adulation: Mr Museveni does not allow political parties to operate. But even that may be about to change.

Uganda is what Mr Museveni calls a “no-party democracy”. Political parties are allowed to exist, but barred from doing any of the things that parties normally do, such as holding rallies, electing leaders or opening offices outside Kampala, the capital. The ruling party faces no such restrictions, on the grounds that it is a “movement”, not a party.

Mr Museveni has long argued that Uganda is not ready for multi-party politics, because parties would inevitably represent tribes, rather than ideas or social classes. Westminster-style, winner-takes-all politics, he maintained, would surely lead to ethnic strife.

It is not an absurd argument. During the 1980s, soldiers from Mr Obote's Langi tribe cut down members of other groups in their hundreds of thousands, and stacked the skulls by roadsides. But the argument is also self-serving: the absence of an effective opposition makes it unhealthily easy for Mr Museveni and his National Resistance Movement to win elections.

So Ugandans were surprised to hear last week that Mr Museveni has decided to allow parties after all. The official press reported, a bit late in the day, that in January he had urged a committee on constitutional reform to stop blocking pluralism. He has not yet spelt out any details. John Nagenda, one of his advisers, says that Mr Museveni wants “the people” to decide, possibly through a referendum.

Why now? Donor pressure is one factor. Uganda has a new rival for the West's affections in east Africa, since the Kenyan opposition crushed the crooked regime of Daniel arap Moi at an election in December. Donors are also concerned about Mr Museveni's lavish defence spending, and his military adventures in Congo. Allowing more political freedom should win back wavering benefactors.

It may be, however, that domestic factors are more important. Multi-party democracy may carry the risk of fomenting violence, but so does its absence. Kizza Besigye, the man whom Mr Museveni defeated at the last presidential election, in 2001, has hinted from exile that he may launch a guerrilla war against the government, citing the impossibility of effecting change by peaceful means. Allowing parties to operate would make Mr Besigye's war-cry sound hollow.

Mr Museveni is still popular, but not universally so. Urban voters gripe at the corruption of many of his lieutenants. The largest tribe, the Baganda, rallied in a vast throng in January to demand greater autonomy. In the north, Mr Museveni's troops have struggled to quell the Lord's Resistance Army, a band of murderous, child-abducting religious rebels. Young Ugandans, who do not remember the bad old days, are not particularly grateful to Mr Museveni for having delivered their parents from Mr Obote, and even their parents wonder how long Mr Museveni plans to remain in charge. “At what point do we stop thanking the guy for not killing us?” asks David Ouma Balikowa, editor of the *Monitor*, an independent daily.

The constitution bars Mr Museveni from standing for another term in 2006, and he insists that he will not break this rule. But a referendum on allowing political parties could provide an opportunity simultaneously to scrap those term limits, in which case he could stand again with a clear conscience. He may be betting that various opposition leaders will have fallen out with each other by 2006. And by appearing to embrace democratic change voluntarily, rather than being forced into it, he would improve his stature with voters and donors alike.

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Poland's government

A bad patch

Feb 27th 2003 | WARSAW
From The Economist print edition

Reuters

Distrusted politicians, limp economy, corruption. Hail the new Europe?

Get article background

IT IS not just the dreary winter that has put Poles in a grim mood. The (ex-communist) Democratic Left government of Leszek Miller, pictured above, is failing. To Donald Rumsfeld, America's defence secretary, Poland is part of “new Europe”. But for the first time, says one Warsaw professional, despite the country's westward gaze, “I feel as if I'm living in Russia.”

National pride and Polish excitement at the country's re-emergence as an actor on the global stage may have pepped morale up a bit (see article). But trust in the political system—and in politicians—has fallen. The legal system is a wreck: even minor cases take years to be heard. And the economy is in the doldrums.

Its growth of 2.6% forecast for this year will not be enough to cut unemployment or pay for better hospitals, schools, railways and roads. As the vaunted “Polish tiger” comes to look ever more like a mangy domestic cat, foreign investment has tailed off. Peugeot, a French car company, recently chose Slovakia over Poland for a new factory.

Mr Miller and his wobbly government are compounding the misery. Several members have left or been forced out while some notably unpopular ones have dug themselves in. The finance minister, Grzegorz Kolodko, is doing better than markets expected but will struggle to push through the reform of public finances that Poland sorely needs.

On top, there is corruption. Since January, Poles have been gripped by “Rywingate”, a scandal that has threatened to taint Mr Miller. The charge is that Lew Rywin, a prominent film producer, tried to solicit a $17.5m bribe from Adam Michnik, a former dissident who edits Poland's most popular newspaper, *Gazeta Wyborcza*. Mr Rywin claimed to be speaking for powerful figures in the ruling party. In return for the bribe he promised the passage of a media bill in parliament that would allow Agora, the newspaper's parent company, to move into television.

That Mr Rywin asked for the money is not in doubt; Mr Michnik secretly taped the conversation. The rest is fuzzier. They were talking back in July, but Mr Michnik did not publish his story until after Christmas. Why not? He says he did not want to damage Poland's bid to join the European Union, so he decided to wait until after last December's Copenhagen summit, when the country was formally invited to join, all

being well, next year—provided the Poles say yes in a referendum in June.

Mr Miller's silence was just as odd. He met Mr Rywin and Mr Michnik soon after the taping and heard the story from both of them. But he did not report Mr Rywin's alleged demand for a bribe, as required by law. Mr Miller says that he thought it all a “grotesque fantasy” in which Mr Rywin had “gone mad for money”. A parliamentary investigation is now trying to discover who in top circles, if anyone, sent Mr Rywin on his dubious mission.

There is no evidence that Mr Miller endorsed, let alone initiated, the alleged scam. “He has no control over corrupt underlings,” says a western diplomat. “The system is rotten.” Indeed, the fact Mr Rywin may have thought he could get away with it is proof, some say, that this kind of thing goes on all the time in Poland, probably up to ministerial level.

Reputations have suffered all round. Mr Miller will probably be exonerated by the inquiry, though his authority has suffered. Mr Rywin looks finished as a public figure. As for Agora, some in the government have made much of the fact that the scandal came to light only after a steady slide in *Gazeta Wyborcza*'s circulation.

Veering rightwards again?

Who has gained? Two far-right populist parties, the League of Polish Families and Samoobrona (Self-defence), have been hoping—so far in vain—to benefit. To their supporters, the Rywin scandal confirms all they have been saying about a nebulous Warsaw elite stealing from ordinary Poles.

So Poland is ill at ease. Breakneck economic growth in the mid-1990s has given way to disappointment and nervousness. Public disillusion, first with the old Solidarity-based parties, now with the supposedly modernised ex-communists, is rife. A prickly wariness about Poland's place in the world is increasing.

Yet, for all these wobbles and worries, the country is secure in its oft-threatened independence and has emerged incontestably as the most muscular of the countries about to join the EU—and as a force soon to be reckoned with at the top table in Brussels. Youthful energy, albeit temporarily frustrated, abounds. Despite recent hiccups, a “new Poland” is still being built.

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Polish foreign policy

Frosty for the French

Feb 27th 2003 | WARSAW
From The Economist print edition

Poles love America but want to be at the heart of Europe too

Get article background

THEY have a new nickname in Warsaw for the French president: Jacques Brezhnev. Mr Chirac's rebuke to Poland and other central European countries for signing a pro-American letter in the midst of the Iraq crisis has not—to put it mildly—gone down well. Wladyslaw Serafin, head of the main farmers' union, says that the emergence of a “western Brezhnev” has made it harder to campaign in favour of Poland joining the EU when the country votes in a referendum in June. Even Bronislaw Geremek, a francophile former foreign minister, has scolded the Polish government for not rebutting Mr Chirac more vigorously.

It is hard to gauge how enduring the impact of the French president's comments will be. Roza Thun, who runs the pro-European Robert Schuman Foundation in Warsaw, says his remarks have not caused too much of a stir among the population at large. So she hopes their effects will be limited.

Ironically, many Polish intellectuals think that Mr Chirac's fears about the impact of the Poles and other central Europeans pushing an American agenda once they join are misplaced. Lena Kolarska-Bobinska, director of the Institute for Public Affairs in Warsaw, points out that opinion polls show that Poles put a higher priority on cultivating relations with the EU than on improving ties with the Americans. She also doubts whether central Europeans will promote a highly individualistic, free-market vision of society that is closer to the American model than to the EU's. On the contrary, she says, Poles like the communitarianism of today's French and Germans.

Even when it comes to the issue of the day—Iraq—the gap between western and central European views can be exaggerated. Opinion polls across the “new Europe” show big majorities of Poles, Czechs and Hungarians also against a war on Iraq. But their opposition is a lot more muted—and many Poles are delighted by reports that the Americans may move some of their military bases from Germany to Poland. While anti-war demonstrations in western European capitals drew hundreds of thousands of protesters, a crowd of barely 2,000 attended a similar one in Warsaw.

That reflects the emotional gap between western and central Europeans in attitudes to the United States. As the Schuman Foundation's Mrs Thun exclaimed to a crowd of stony-faced journalists visiting from Brussels: “Here in Poland we love the United States. We feel European, but we love America.”

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Austria's new government

The same peculiar team?

Feb 27th 2003 | VIENNA
From The Economist print edition

Though weaker than before, the far-right is likely to stay in government

Get article background

AP

Schüssel makes a clean breast of it

“WHAT did we go to the polls for?” is the commonest question being asked by politically-minded Austrians. After all, it was almost six months ago that Chancellor Wolfgang Schüssel and his centre-right People's Party ended their ruling partnership with the far-right Freedom Party, because the latter was being torn apart by feuds, largely over the role of its maverick behind-the-scenes leader, Jörg Haider. Hence Mr Schüssel's decision to call a general election, which he handily won. Yet now, after three months of negotiating in vain with Social Democrats and Greens, he is poised to team up all over again with the Freedomites.

It would be false, however, to say that nothing has changed. For one thing, the same Europe-wide furore is unlikely to erupt as it did before, when all the European Union's other countries put Austria into diplomatic isolation because of the Freedom Party's apparent neo-Nazi taint. After all, governments in several other EU countries—including Italy, the Netherlands and Denmark—have since come to power with the support of parties on the post-fascist or populist right.

For another thing, the Freedomites are much diminished after their poorer showing in the last election, when they got only 10% of votes cast, compared with 27% in 1999, while Mr Schüssel's party score went up from 27% to 42%. Moreover, Mr Haider himself now wields far less clout. Last time, though Mr Haider let Mr Schüssel be chancellor, it was a coalition more or less of equals. This time the People's Party will be able to govern virtually on its own.

A few years ago the Freedom Party was probably Europe's most successful populist force on the continent. During the decade-plus when he ran it, Mr Haider managed to lift its vote from 5% to 27%. But, with his influence down, the main aim of his disgruntled colleagues is, it seems, to cling to whatever jobs in government they may be offered. Moreover, though many Freedom Party voters remain xenophobic and hostile to the EU, the party itself no longer threatens to veto the EU'senlargement to the east, nor could it do so if it tried.

Still, many Austrians, including many who voted for Mr Schüssel's party, are annoyed by his decision to team up once again with the Freedomites. Both Alfred Gusenbauer, the Social Democrats' leader, and Alexander van der Bellen, who speaks for the Greens, sourly say that Mr Schüssel never intended to forge an agreement with either of them. Most top businessmen would have preferred a resuscitation of the “grand coalition” of centre-left and centre-right that governed Austria from 1986 to 2000, when the Social Democrats were in the driver's seat and Mr Schüssel's people were mainly passengers.

But Mr Schüssel may have decided to stick to the Freedom Party precisely because it is divided and weak. In addition, he argues—with some cogency—that he and his finance minister, Karl-Heinz Grasser, a former Freedomite man who has now sided with Mr Schüssel's party, are determined to shake up Austria's expensive pension and health-care systems, a task for which neither of Austria's parties on the left has much stomach. Only if Mr Schüssel can force through such painful reforms will he have a chance of lightening Austrians' extremely heavy tax burden, which became even heavier during his first term.

Mr Haider may still try to hamstring the renewed coalition before it has got going again. He blames Mr

Schüssel for the decline in his fortunes, vilifies him at every turn, and would love to see him fail. But at the same time he is keen to stay on as governor of the southern province of Carinthia—and for that he needs the backing of Mr Schüssel's party. That may be the price the chancellor will have to pay.

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Russia

Still mourning Stalin?

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Half a century after Stalin's death, Russians shy away from his legacy

SO MANY people suffered in so many ways, by starvation, deportation, and execution, that it is hard to give a complete tally of the human cost of the three decades when Stalin ran the Soviet Union. Anne Applebaum, author of an encyclopaedic new study of the Gulag (and former *Economist* writer), reckons 18m people passed through the camp system, a further 6m were exiled, and 6m-7m died in the artificial famines of the 1930s. Alexander Solzhenitsyn, legendary chronicler of Soviet tyranny, puts the death toll at 20m-plus and reckons that Stalin's brutality deprived the Soviet Union of 100m people who would otherwise have been born in conditions of normality. Yet, extraordinarily, many Russians still look back on the Stalin years as a golden era.

One reason is that much of the period is still cloaked in mystery. After a brief period following the collapse of Communism in the early 1990s, journalists and historians were able to get into the KGB archives. But since then it has become increasingly hard for outsiders to gain access to them.

While most Russians accept that Stalin, who died on March 5th 1953, was a blood-stained oppressor, many still admire him for making their country great. Did he not fulfil the dream of another magnificent tyrant, Peter the Great, by dragging a country of peasants into the industrial and even space age? Some nostalgists even cite the White Sea canal, linking Russia's Arctic coast to the Baltic Sea and built in just 20 months, as a monument to his genius—even though more than 100,000 people perished in the effort.

Viktor Anpilov, head of an avowedly Stalinist party, says that foreigners used to treat Russia with the respect it deserved. It was—he proclaims—the first country to put a man into space, the first where doctors performed open heart surgery, the top of the league of mathematicians and physicists. Now, he moans, outsiders are only interested in Russia's mineral wealth. “They are laughing at us and despise us for our fall,” he says.

Such views, and the xenophobia they reflect, are still common, in public attitudes and protectionist, inward-looking laws and rules on everything from foreign ownership to visas. Other surviving features of the Stalin era include the presumption of guilt in the legal system. Reform is painfully slow. Russia's top prosecutor recently boasted that last year the acquittal rate had doubled—to the grand total of 0.8% of those on trial.

After stalling for 12 years, in January Russia's parliament passed a law granting Stalin's victims and their children compensation, albeit of a symbolic kind: 92 roubles ($2.9) a month, one free train ride a year, half-price medicine, and free false teeth. Recently, in Warsaw, Russia's prime minister, Mikhail Kasyanov, took a more daring step and floated the idea of paying compensation to Stalin's Polish victims.

But there has still been nothing like the Germans' painful and candid acknowledgement of the enormity both of crimes committed then and of collective responsibility now. It may be years yet before Russians face up to the full horrors of the Stalin era, both inflicted and suffered.

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The French press

Woof! Woof!

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From The Economist print edition

One of Europe's great newspapers is under attack

DOES dog eat dog? The icon of the French press is *Le Monde*, a newspaper that is rigorously intellectual, overwhelmingly serious and—according to a book* by two Paris journalists out this week—both politically and financially corrupt. The charge, by Philippe Cohen, of the weekly *Marianne*, and Pierre Péan, who famously uncovered President François Mitterrand's war-time links with the Vichy regime of German-occupied France, is that a triumvirate of the chief executive (also editor-in-chief), the editor and the chairman of the board has conspired to cover up scandals, influence French politics without declaring its interests, and hide the paper's financial weakness.

The editor, Edwy Plenel, is an ex-Trotskyist who, according to Mitterrand, was also a CIA agent. The chief executive, Jean-Marie Colombani, is accused of being a money-greedy hypocrite, who may have saved the paper from bankruptcy in 1994 but nonetheless has too many links for comfort both with French big business and with his Corsican compatriots. When Mr Colombani last year denounced the introduction of free-sheet papers into the French market ("In my view, those papers bring death to high-quality journalism"), he conveniently failed to mention he had earlier been negotiating for *Le Monde* to help just such a paper. As for the chairman of the board, Alain Minc, he was formerly an adviser to Edouard Balladur, a conservative prime minister in the early 1990s—and a man whom *Le Monde* later keenly backed for president.

So much, then, for the vaunted independence of *Le Monde*, a paper founded by the austere Hubert Beuve-Méry in 1944 at the instigation of General de Gaulle to provide journalism free from Vichy's taint. In its place, say Messrs Cohen and Péan, is a "latter-day *PRAVDA*", with a "climate of fear that stifles internal editorial dissent".

To all of which the newspaper has reacted with lofty sarcasm, a promise to sue the authors and publishers for libel—and a failure to rebut specific charges. "Does *Le Monde* threaten France?" the paper asked this week. Its own answer came in the form of an editorial, followed by two pages detailing both the various attacks on *Le Monde* over the years and the paper's financial history. Confessing that it was "flattered" to be the subject of an inquiry, the paper regrets that the resulting book, with its accusations of "a Francophobia, latent or explicit", is an amalgam of "errors, lies, libels and calumnies". Citing Spinoza, the editorial noted that hatred is the saddest of all passions, and "hatred, alas, is what marks this book."

Maybe so. But *Le Monde*'s rivals are happy to let it spread. The weekly *L'Express* (which beat off a bid from *Le Monde* in 1997) last week printed 12 pages of excerpts ahead of the book's publication; this week, the daily *Libération* printed two. In other words, at least some dogs are feasting well.

* "La face cachée du Monde" (The Hidden Side of Le Monde). By Pierre Péan and Philippe Cohen. Edition Mille et Une Nuits; 631 pages; *euro*24.

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Charlemagne

The galling rise of English

Feb 27th 2003
From The Economist print edition

The European Union is becoming an English-speaking zone

FROM his desk at the European Commission's office in Warsaw, Bruno Dethomas has been gloomily monitoring the decline of his native French within the European Union. “When I left Brussels in 1995,” he remarks (in perfect English), “70% of the documents crossing my desk were written in French. Nowadays 70% are in English.” In Brussels Mr Dethomas was chief spokesman for Jacques Delors, the powerful and charismatic French head of the European Commission who stepped down in 1995. Until that year the sole working language in the commission's press room was French, but it was already clear which way the wind was blowing. “Quite often,” says Mr Dethomas, “I would give the official briefing in French, and then I would have to give a second briefing in my office in English.”

The rise of English as the EU's dominant working language was given a decisive push by the Union's last expansion, in 1995, when Austria, Finland and Sweden joined the club. Officials from all three countries, especially the two Nordic ones, are much more likely to be fluent in English than French. The Union's public voice is increasingly anglophone. For a brief period earlier this year the spokesmen for all three major institutions in Brussels—the commission, the European Parliament and the Council of Ministers—were British. Jonathan Faull, the commission's chief spokesman, will be replaced this month by Reijo Kemppinen, a Finn. But for French-speakers the change is a double-edged sword. The good news for them is that this high-profile job will no longer be held by a Briton; the bad news is that Mr Faull's French is rather better than Mr Kemppinen's.

The fact that the key EU institutions have bases in francophone cities—Brussels, Luxembourg and Strasbourg—means that lots of French will continue to be spoken in the EU's corridors and meeting rooms. But the grip of English will tighten still more next year, when the Union will take in ten more countries, mainly from central Europe. The commission is planning to recruit over 3,000 Eurocrats from the former communist block. The best guess is that some 60% of them will speak English as their second language; for only 20% or so will it be French.

The shift towards English within EU institutions reflects what is happening in the wider world. A recent study by the EU's statistical arm showed that over 92% of secondary-school students in the EU's non-English-speaking countries are studying English, compared with 33% learning French and 13% studying German. Despite recent avowals of undying Franco-German friendship made by the two countries' governments, fewer and fewer French and German children are learning each other's languages. The trend is the same in the countries about to join the EU. The only place where more secondary-school students are studying French than English is Romania, though German runs English close in several central European countries. English is also increasingly Europe's language of business.

But the rise of English within EU institutions particularly alarms the French elite because for many years the Brussels bureaucracy has been a home-from-home, designed along French administrative lines, often dominated by high-powered French officials working in French. Moreover, the emergence of English as the EU's main language gives an advantage to native English-speaking Eurocrats. As Mr Dethomas notes: “It's just much easier to excel in your own language.”

Some French officials argue that there are wider intellectual implications that threaten the whole European enterprise. In a speech at a conference in Brussels on the French language and EU enlargement, Pierre Defraigne, a senior official at the commission, argued that “it's not so much a single language that I fear but the single way of thinking that it brings with it.” When French was Europe's dominant language in the 18th century, French ideas were the intellectual currency of Europe. Voltaire was lionised at the Prussian court; Diderot was fêted by Russia's Catherine the Great. These days, however, ambitious young Europeans need to perfect their English and so tend to polish off their

education in Britain or the United States, where they are exposed to Anglo-Saxon ideas. For a country like France, with its own distinct intellectual traditions in economics, philosophy and law, such a trend is understandably galling. The commission's Mr Defraigne worries aloud whether “it is possible to speak English without thinking American.”

Tongue-tied

The desire to protect and promote its language is a thread that runs through France's policy in the Union. For instance, longstanding efforts to develop a common EU patent-law have been stymied because France cannot accept English as the sole language for patents; and if French is made valid for EU patents, then the Germans, Italians and Spanish insist that their tongues should also be included. France has also consistently fought to prevent the EU gaining control of trade policy relating to “cultural industries”, lest this impede efforts to protect French-language films and music. And the French government has keenly championed Romania as a candidate to join the Union because the French consider that country, however bizarrely, to be part of “la Francophonie”. One reason why Jacques Chirac, France's president, recently singled out Bulgaria and Romania for particularly biting criticism of their pro-American foreign policies may have been irritation that, despite those assiduously nurtured cultural links, the Romanians have not proved reliably francophile after all.

The more realistic French officials acknowledge that however much cash and energy are put into the promotion of French within the Union and elsewhere, it is a losing battle. “This is a real trauma for France,” says Mr Dethomas. “Our only revenge is that the English language is being killed by all these foreigners speaking it so badly.”

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Freedom and anti-terrorism

Coming quietly

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Britain's draconian anti-terrorism laws are popular and uncontroversial. So far

NEW laws and old ones combined give Britain, worriers say, the toughest anti-terrorism legislation of any advanced democracy. There is more to come. In April, the home secretary will gain new powers to strip immigrants of their British citizenship. A likely target is Abu Hamza el-Masri, an Egyptian-born extremist Muslim cleric who gained a British passport in 1982. The minister responsible, Beverley Hughes, says that the government plans to “deal with him” under the new law.

If Mr Hamza claims a justifiable fear of torture or persecution in Egypt, he will not be deported. But the government may lock him up without further ado. Indefinite detention, along with vague laws, secret evidence, suspects guilty until proved innocent, punishment by politicians not judges, with limited rights of appeal and of access to lawyers—these have not so far been leading features of the British system of justice. But things have changed.

The biggest dent in the rule of law is in equal treatment for everyone. Under the anti-terrorism act, rushed into law in December 2001, foreigners can be treated more harshly than British citizens. The home secretary can have non-British terrorist suspects locked up without trial, although they are free to leave the country: of the 15 detained so far, two have gone.

The identities of the rest are secret. They are being kept in closely guarded detention, in conditions that Amnesty International and other human-rights watchdogs have sharply criticised. The government says it has now made “substantial” improvements and plans more.

The authorities are mainly using the immigration rules, rather than the criminal justice system, as a way of keeping terrorist suspects locked up. The legality of this is still fiercely contested. To make it possible at all, the government had to declare a state of emergency, and withdraw from Article 5 of the European Convention on Human Rights. This case is now going to the House of Lords.

The second big shift is in the kind of evidence allowable. The government can now use much more “closed” evidence—meaning stuff gathered by spookery, bugging and arm-twisting, that normally would be hard to use in court. It has also gained new access to tax and bank records.

The biggest row is about the use of this stuff in two tribunals, one that hears appeals from organisations

that have been banned because of their terrorist activities, the other which hears appeals from terrorist-related immigration cases. Their members and hearings are secret. Defendants may be denied access to the evidence considered. Defence advocates are drawn from a special pool of lawyers cleared to see secret material. Rights of further appeal are limited to points of law, not of fact.

A third big watering-down of legal principles in terrorism cases is that the burden of proof has shifted to the defendant. Anyone linked, even loosely, to a banned organisation may have to prove in court that they are not a terrorist. Definitions are drawn very widely. Geoffrey Bindman, a lawyer acting for one banned outfit, notes that as any meeting in support of the group attended by three or more people is a criminal offence, he and his legal colleagues are potentially breaking the law even when they meet to discuss the group's appeal.

A lot of this is supposedly temporary. The toughest bits must be regularly renewed by Parliament. There are independent reviews of the different laws, although these report some way in arrears: how the laws are working in practice now is still mostly unclear. Two reviews are headed by Lord Carlile, a senior lawyer and former Liberal politician. He sees secret evidence, talks to lots of people, and says it is all working reasonably well. A second review, by a seven-person cross-party group from the Privy Council, a body of trusted top politicians, will report by the end of the year.

It is hard to prove that a tough regime of this kind is either definitely necessary or clearly an over-reaction. But sceptics note that there are plenty of other laws that deal with people planning to kill people, or even those who talk about it. This week another incendiary Muslim cleric, Abdullah el-Faisal, was found guilty of soliciting murder, in speeches and publications that encouraged his followers to kill Jews, Hindus and westerners. The charge, of soliciting murder without a specific victim in mind, was a rare one, last used in 1905. The maximum penalty is life imprisonment.

Whether it is through hurried new laws or dusted-off old ones, civil-liberties groups fear that the real effect of the government's current approach will be to alienate law-abiding Muslims. That, they say, is what happened with moderate Irish nationalist opinion as the government sought to crush the IRA in the 1970s. Tough anti-terrorism laws, including internment without trial, caused huge ill-feeling, and did little to put real terrorists behind bars. Most of the IRA “bombers” sentenced for the attacks on the British mainland after 1974, they note, turned out to be wrongly convicted.

The government is softening its position slightly. In particular, it is considering whether to take up the case of the seven British citizens being held by the American authorities in Guantanamo Bay in Cuba, who are currently in a legal black hole, deprived of any legal representation anywhere. But public sympathy in Britain for such cases is still pretty limited. Unless and until that changes, the government can expect a fairly free hand.

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Justice

Snatch and grab

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Confiscating the cash of people who haven't been convicted of a crime

IT TOOK the police almost 20 years to nab John Palmer, nicknamed “Goldfinger”, following his acquittal for masterminding the £26m ($39m) Brinks-Mat gold bullion robbery. When the law finally caught up with Mr Palmer in May 2001, he was jailed for eight years for a timeshare fraud. Ever since, the authorities have been trying in vain to confiscate £33m of his assets.

Cases such as this have led the government to set up the Assets Recovery Agency this week to confiscate wealth it believes was ill-gotten. The new agency will not have to prove that a criminal offence has been committed, only that it is probable that assets were acquired illegally. The onus will be on the owner of the flashy villa and the yacht in Northern Cyprus to show that these were acquired honestly.

The police have hailed it as an important weapon against a group of around 150 super-criminals who they claim are, in effect, untouchable under current laws. “They don't commit crimes themselves, they manage criminal enterprises,” says Sir David Phillips, chief constable of Kent.

The British Assets Recovery Agency is modelled closely on the success of the Irish Criminal Assets Bureau (CAB), set up in 1996. It claims that in its first four years of operation the bosses of six organised crime groups fled the country to escape its clutches. An early success was the leader of a heroin gang that had an estimated annual turnover of £2m a year. When the bureau targeted properties registered in his father's name, he fled abroad and his business fell apart. America has the longest established asset recovery programme, which produces more than $150m a year.

Seizing assets allegedly acquired through crime without requiring criminal standards of proof represents a big extension of state powers. That does not worry the home secretary, David Blunkett. “If we can't convict the buggers, let's deny them their ill-gotten gains,” says one Home Office adviser. But John Wadham, director of Liberty, a civil rights group, says that this amounts to “a violation of the presumption of innocence”. Michael Levi, professor of criminology at Cardiff University, says the new law is bound to be challenged under human rights legislation.

Even if the British recovery agency survives the scrutiny of the European Court, it may not achieve a great deal. Its target for recoveries over the next three years is a modest £60m—which won't make much of a dent in the £18 billion of assets which the National Criminal Intelligence Service estimates have been acquired criminally. A study by the Council of Europe says there is no evidence that America's asset recovery programme has made much impact on organised crime. Career criminals quickly learn how to put their assets beyond the reach of both the law and their fellow villains.

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Britain and the euro

Not yet

Feb 27th 2003
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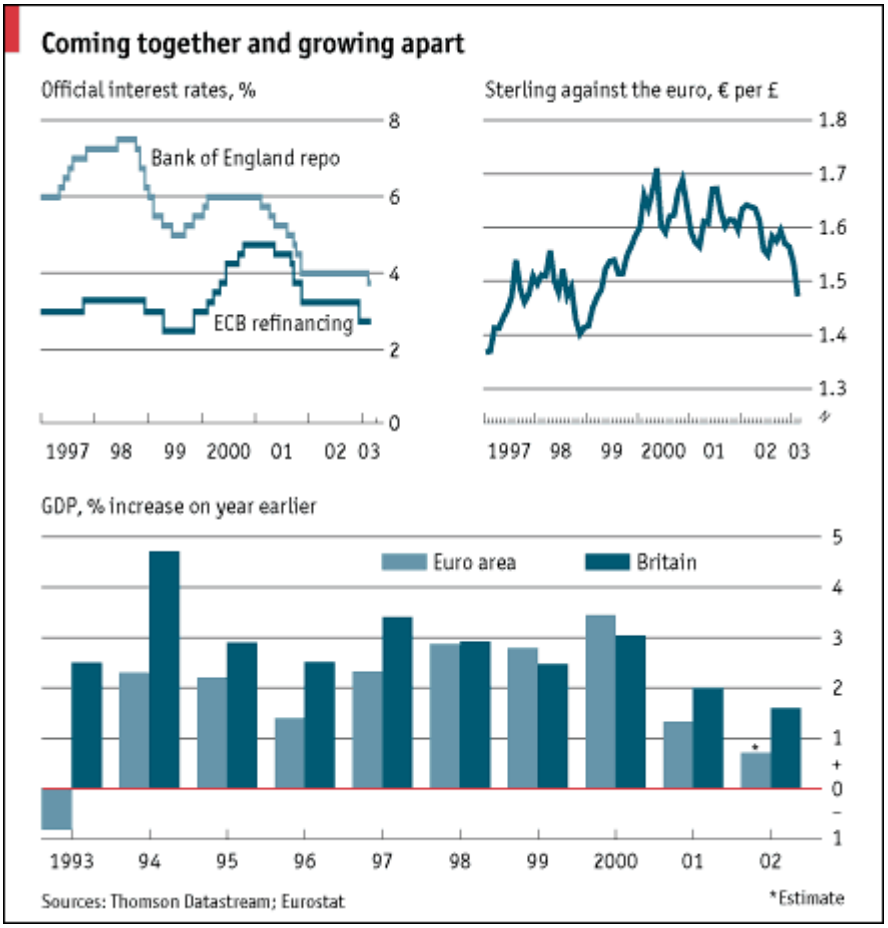
Gordon Brown seems to be winning his fight to put off a euro referendum

Get article background

IMPENDING war has not dimmed Tony Blair's enthusiasm for the euro. Rather the reverse, it seems. One of the side-effects of a quick victory, it is suggested in Downing Street, could be to strengthen Mr Blair and thus make it likelier that a referendum could be held during this parliament. But, with the deadline for Gordon Brown's judgment on his famous five tests only three months away—and the announcement may come sooner—economics are pushing in the opposite direction.



On February 27th, Mr Brown gave evidence to a parliamentary committee carrying out its own inquiry into euro membership. The chancellor, who wants to present his assessment on his own terms, stonewalled his way through the session. But his manner and tone reinforced the impression that the Treasury's answer to the five tests, which he said would be “clear and unambiguous”, would be: not yet.

The Treasury's tests ask: how convergent the economy is with the euro area, whether it is flexible enough to lose the shock absorber of its own exchange rate, what would happen to investment, how the City would be affected, and what the overall impact would be on jobs and prosperity. But two simple questions lie at the heart of the matter. Would the economy perform better within the euro area? And could it cope with interest rates set by the European Central Bank (ECB) and fiscal policy governed by European rules?

In principle, Britain should benefit from being part of a single-currency area. At a stroke, exchange-rate risk for half the country's trade is removed. More trade means more competition, which tends to raise productivity. Companies—especially foreign ones wanting to sell to the euro area's 300m people—should be more willing to invest because they will no longer have to worry about the erratic value of the pound against the euro.

Early evidence suggests that some of this is already happening. Trade within the euro area is rising as a proportion of those countries' GDP. And Britain's share of foreign investment in the EU by companies has recently fallen, although this is partly because takeovers are out of fashion.

What's more, say those who want to join soon, Britain can now cope with membership because its economy is converging with the euro zone's. When Mr Brown ruled out membership in October 1997, short-term interest rates were almost four percentage points higher in Britain than in France and Germany. Now the gap is only one percentage point, although it will widen again if the ECB cuts interest rates next week. An underlying measure of convergence is whether the two economies have roughly the same margin of spare capacity. In 1997 they did not. Now they nearly do.

But the Treasury's assessment is likely to warn that long-term potential gains will be at risk if the EU fails to make the economic reforms—better performing labour, product and capital markets—that it promised in Lisbon three years ago. In his evidence to the committee, Mr Brown told MPs “we want to see a lot more progress”. The Treasury is particularly worried that many European labour markets are still too inflexible.

Anyway, even if the economies are converging, Britain would not necessarily benefit from having its interest rates set by the ECB. If house prices—which have been rising far faster than those in the rest of Europe—crashed, Britain might then need lower interest rates than in the euro area.

Another worry is the slow growth of mainland Europe. The Treasury is likely to argue that the way the euro area conducts economic policy is partly to blame. The ECB has been slower to cut interest rates than the Bank of England. Mr Brown thinks that the framework under which the Bank operates—trying to keep inflation at around 2.5%—is superior to the ECB's goal of keeping inflation below a ceiling of 2%, because the latter leads to excessively tight monetary policy.

Mr Brown also dislikes the stability pact, under which countries are supposed to try to balance their budgets and can face fines if deficits exceed 3% of GDP. This has forced, for instance, Germany and Portugal to tighten fiscal policy instead of easing it to help their limping economies. Britain, which has low public debts but needs to borrow to rebuild its infrastructure, could find its freedom to do so constrained by this fiscal straitjacket. The European Commission has been sympathetic to this pleading for special treatment but European finance ministers were less so when they met on February 18th. Thus the stability pact could force Mr Brown to raise taxes further if Britain joined the euro.

Choosing the right exchange rate to join at is not, formally, one of the tests; but everybody knows it is crucial. If too high a rate is chosen, Britain would have to endure a long period of slower growth to make its wages and prices more competitive. One reason why Germany's economy is in such a mess is that it entered the euro at too high a rate.

For most of the past four years, the pound has been too strong to join the euro. In recent months it has fallen quite a lot, but it probably needs to fall further. Goldman Sachs reckons that a realistic rate would be 1.37 euros to the pound, compared with about 1.47 now. But there is a fiscal sting in the tail. To offset the stimulus to the economy from this further depreciation, Goldman Sachs says that fiscal policy would have to be tightened by 1% of GDP, requiring tax increases of about £10 billion. And they would have to come before rather than after the next general election.

On balance then, the Treasury is likely to judge that the risks of joining the euro are too serious to contemplate early membership. That will be frustrating for the prime minister. So there is likely to be a face-saving formula which will leave open the door for a possible referendum in 2004. It will only be notionally ajar. A referendum looks likelier in Labour's third rather than second term of office.

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Energy and environment

Say watt?

Feb 27th 2003
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The government's new energy policy is good but still incomplete

BRAVE and important, or a wordy fudge? The laudable aim of this week's energy white paper—termed a "milestone" in policy by Tony Blair—is to balance long-term energy needs with environmental goals. It calls for a 60% cut in greenhouse gas emissions by 2050. That ambitious target, recommended by the Royal Commission on Environmental Pollution a few years ago, goes well beyond the short-term cuts required by the Kyoto treaty on climate change. Mr Blair even insists that the world must embrace a "low-carbon" energy system if the economic growth to come this century is to be sustainable.

That means a decision on whether to support those, like Brian Wilson, the energy minister, who argue for nuclear energy because it produces no greenhouse gases, or to back the greens who argue with equal vehemence that renewables should fill the gap. Both camps have demanded huge subsidies and other forms of state support for their pet schemes.

At first blush, it seems that Mr Blair has waffled. The paper says renewables' share in the energy mix should rise to 20% in 2020, up from today's 3% (far below the levels found in most European Union countries). But that 20% target is merely an "ambition" and not a binding target; greens also observe sourly that the £60m of new money the government is offering renewables is but a tenth of the amount splurged recently to keep British Energy, a nuclear generator, afloat.

The nuclear camp is pleased that he did not explicitly rule out replacing ageing nuclear plants with new ones, but are upset that they receive no new money. But the cost, delay and risk involved in a new nuclear power station are enough to deter any private operator. Margaret Beckett, the environment secretary, notes wryly that "there's no queue waiting to build new nuclear power plants".

The white paper does reveal that Mr Blair is more market-minded than many had previously thought. His plan rejects the claim for special subsidies for domestic generators on "energy security" grounds. That argument is often made by the nuclear camp to do down imported gas, much of which in future will come from Russia. The new policy celebrates Britain's successful liberalisation of power and gas markets, and promises to push the rest of the EU to liberalise too. For the first time, it commits Britain firmly to joining a pan-European initiative for trading greenhouse gas emissions.

That may sound technical but it will have sharp teeth. Callum McCarthy, the independent energy regulator, says that the mandatory emission caps involved will clearly influence industry to move toward low-carbon energy sources.

What is more, argues Tom Delay of the Carbon Trust, a state-funded group that invests in clean energy, the policy "has wisely left it to the market to decide which of the main low-carbon technologies should flourish: nuclear, renewables, carbon sequestration [a way of using fossil fuels in a cleaner way] or energy efficiency".

Mr Blair and his officials still need to come up with specific policy measures in coming months to back up the grand talk. But so far the strategy looks well thought-out and workable. John Gummer, a former Tory environment minister, praises Mr Blair for sending such "a powerful signal to the marketplace to take greenhouse gas emissions seriously".

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Consumer credit

The sharks are circling

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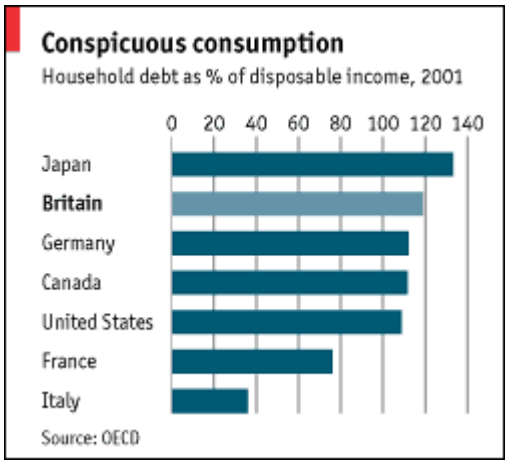
The government wants to rein in the booming high-interest loan business

NICHOLAS DICKSON was found guilty of lending money without a licence in April last year. In Manchester, Mr Dickson lent small sums—up to £300 or so—to housewives without their husband's knowledge and took their benefit books as security. In return for lending £20 for two weeks he demanded £30 back; an annual rate of over 3m%.

Mr Dickson's case was an unusual one. Hardly any high-rate money-lenders, either legal or unlicensed, ever get prosecuted. Indeed, Britain has been long accused by debt-advice organisations of being an overly hospitable environment for lenders who charge extortionate rates of interest. The Consumer Credit Act of 1974 applies only to borrowings of £25,000 or less, which means that bigger loans secured on property—the most dangerous sort—fall outside its scope. Its provisions on what it calls “extortionate credit” are vague.

People are deeper in the red these days than ever before. Britain is Europe's most indebted big economy (see chart). Almost a quarter of British families have got into financial difficulties in the past year, according to the Department of Trade and Industry, and one in five is in trouble now. Elaine Kempson of Bristol University says that millions of Britons have loans that could be considered extortionate.



Rising house prices mean that the biggest growth area is in loans secured on homes. Typically, a household struggling with debts would answer an advert offering to consolidate them all for a lower overall rate. After taking its cut, the debt consolidator gives a new loan, secured on the family's property. In 2000, according to a survey of consumer credit providers by the Finance and Leasing Association, a trade body, over half of the year's new £1.8 billion of secured lending was used by consumers to pay off existing debts. The government is particularly worried about loans secured on property, because if people get turfed out of their houses, the state will have to pick up the pieces.

The government wants to discourage heavily indebted people from borrowing more. Both the Office of Fair Trading and the Department of Trade and Industry are paying new attention to the various fast-growing businesses—sub-prime lenders, debt consolidators, doorstep lenders—that are making money from people with bad credit histories or those desperate to take on more debt to pay existing loans.

Practically anyone can get permission to lend money. The government wants to make it harder to get and keep a licence. Melanie Johnson, minister for competition, consumers and markets, says she wants lenders to assess their customers' ability to repay before lending more to them. And the government is proposing to scrap the Consumer Credit Act's £25,000 limit and to get rid of its various exemptions so that it covers all credit agreements.

In March, the government plans to revise the rules on extortionate credit. The government is not proposing a cap on rates—which some people want, and some European countries have—but it plans to set up a new consumer-credit ombudsman who could, for instance, allow people to tear up their loan agreements without going to court, and also wants to take steps to help borrowers mount class-action lawsuits against lenders.

There is little it can do about the nastiest end of the business—unlicensed lenders. Their clients are usually too frightened to complain to anyone. In Newcastle, says a trading standards officer, borrowers get dog excrement through their letter-boxes. Debt-collectors in Glasgow have been known to dangle children over stairwells and beat up their parents in front of them, says Ms Kempson. New regulations won't touch those people; and there is a danger that, by increasing the regulatory burden on licensed lenders, the government will either swell their numbers, or reduce the amount of credit available, or both.

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Conservative leadership

Mr Nasty and Mr Nice

Feb 27th 2003
From The Economist print edition

A possible way out of the Tories' seemingly interminable troubles

Get article background

THE last fortnight may well have sealed the fate of Iain Duncan Smith, the Conservative Party leader. Nobody denies that his job is a difficult one. The trouble is, as an exasperated MP put it this week, “almost anyone could do it better than Iain.”

Among his other deficiencies, Mr Duncan Smith does not seem to learn from his mistakes. Last summer, he fired his party chairman and political rival, David Davis, while Mr Davis was on holiday. Mr Davis, it was put about, was disloyal and incompetent. Not surprisingly, Mr Davis and his friends were furious about his treatment and the subsequent spin. Whether or not Mr Duncan Smith had been right to sack Mr Davis, his handling of it could not have been worse. If there was a question mark over anyone's competence, it was over his rather than that of Mr Davis.

A few days ago, Mr Duncan Smith did it again, although this time it was the turn of the Tory chief executive, Mark MacGregor, to get the boot while on holiday. Like Mr Davis, Mr MacGregor was accused of disloyalty, as were two colleagues—the party's popular chief agent, Stephen Gilbert, and its very bright head of research, Rick Nye—who were fired at the same time. Unlike Mr Davis, these men were mere backroom boys of whom few people not closely involved in politics had ever heard. Mr Duncan Smith must have calculated that they could be cast aside without much fuss. He was wrong.

Although mere apparatchiks, their firing was politically more important than Mr Davis's. His differences with the leader were personal; theirs were ideological. All three are keen “modernisers”, that is to say supporters of the attempt to redefine Conservatism as more socially inclusive and liberal. When Mr Duncan Smith named Barry Legg as not just Mr MacGregor's successor, but also his chief of staff, the reason for the sackings became clearer. The Tory leader was swinging rightwards, in just the same way as his predecessor, William Hague, did, and he wanted only likeminded lieutenants. Mr Legg, an old crony and fellow Maastricht rebel, fitted the bill. Unfortunately he is neither liked nor trusted by many Tory MPs. As one observed: “If Barry Legg is the answer, what, in God's name, is the question?”

The Central Office Three had all been Portillistas, as admirers of Michael Portillo, a defeated leadership candidate, are known. After their dismissal, Mr Portillo went on the attack. The essence of his critique was that Mr Duncan Smith had revealed himself as a small man, attempting to surround himself with ideological soul-mates and political toadies. Mr Portillo's words struck home like nails in Mr Duncan Smith's coffin. The debate at Westminster is no longer about whether Mr Duncan Smith will be forced out, but when.

There are just two problems. First, at a time when the government is vulnerable, the tortuous method by which a new leader is elected ensures at least three months of paralysis and infighting (so nothing new there). Second, and more seriously, it is hard to see who could unify the party while making it more attractive to voters.

Mr Portillo, though still an exciting politician, has assumed the mantle of assassin—a role incompatible with the leadership he claims no longer to seek. Kenneth Clarke's refusal to temper his Europhilia one jot—this week, he in effect lined up with the French and the Germans by voting against the government's tough line on Iraq—must disqualify him from leading a predominantly Eurosceptic party. The idea once touted of a Clarke-Portillo dream ticket looks anything but to most MPs. David Davis, though ambitious and dynamic, is only slightly more popular among his colleagues than Mr Legg.

One possible solution is, however, gaining ground. The Tories' two most effective front bench performers are the shadow chancellor, Michael Howard, and the shadow home secretary, Oliver Letwin. Mr Howard, who is clever, street-wise and a ruthless debater, now frequently draws blood when he squares up to the previously indomitable Gordon Brown. Mr Howard may be a Thatcherite retread, but nobody doubts that he would be more effective than Mr Duncan Smith.

Mr Letwin's palpable niceness would provide a useful counterweight to Mr Howard's chilliness. At times he appears to be engaged in a form of conversation with the government, his well-founded criticisms often made in a spirit of sorrow rather than anger. Even while exposing the shambles of the government's policy on asylum-seekers, he still manages to sound humane and well-intentioned. It has made him surprisingly formidable.

Both men are apparently loyal to Mr Duncan Smith; and Mr Letwin has indicated, probably rightly, that he lacks the experience to be leader just yet. But if it became clear that Mr Duncan Smith was for the chop, Messrs Howard and Letwin could well be the nearest the party can get in present circumstances to a dream ticket. Their job would be to maximise the Conservative vote at the next election, after which Mr Howard would give way to his much younger deputy. All a little too neat? Maybe, but what the Tories need now is a reason to hope.

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Bagehot

The moral imperative

Feb 27th 2003
From The Economist print edition

Is Tony Blair too moral for the bishops?

Get article background

WHICH of these is most likely to give Tony Blair sleepless nights? The fact that on February 26th 121 Labour MPs voted for an anti-war amendment after a heated debate on the government's Iraq policy? Or that Rowan Williams, the new Archbishop of Canterbury who was enthroned the following day, believes that military action to disarm Saddam Hussein does not meet the criteria of a just war?

Although the rebel vote was a good deal bigger than had been predicted, there is no doubting that it is the latter which causes the prime minister most anguish. While it is almost *de rigueur* for the American political classes to proclaim their piety—President Bush likes everyone to know that he is a born-again Christian, while even Bill Clinton felt comfortable employing the language of the pulpit—Mr Blair is unusual among British politicians in that he is not only deeply religious, but that his faith informs much that he does. Indeed, Mr Blair is the most overtly Christian prime minister since William Gladstone quit Downing Street for the last time in 1894.

Last weekend, Mr Blair even took time out for a private audience with the pope that he had himself requested. This was quite an odd thing to do given that Mr Blair is not himself a Catholic (although his wife is) and that the pope, who also condemned the first Gulf war, is implacably opposed to any military action against Iraq. Mr Blair could not have hoped to change the pope's mind—the church has officially declared that there is nothing in the catechism that supports the notion of pre-emptive war. He knew that he would be denied absolution for whatever was to come, but it was still vitally important for him to explain to the pope the moral basis of his policy.

Mr Williams may not quite be as unbending as John Paul II. But he delivered a clear enough warning to the prime minister in a statement on Iraq made jointly with his Catholic opposite number, Cardinal Cormac Murphy O'Connor, just a few days after Mr Blair, in response to massive anti-war demonstrations on February 15th, had spoken passionately about the morality of regime change in Baghdad.

Putting aside the legal technicalities of Iraqi compliance or otherwise with UN disarmament resolutions, Mr Blair had said: “The moral case against war has a moral answer: it is the moral case for removing Saddam.” The good that would come from getting rid of a man who had massacred his own citizens and been directly responsible for the death of millions in war meant that, if forced to act, “we could do so with a clear conscience.” Unfortunately, the two archbishops begged to differ, calling for the continuation of weapons inspections to “render the trauma and tragedy of war unnecessary”, a war, moreover, they believed to be of questionable “moral legitimacy”.

Onward Christian soldier

Unlike most of his predecessors in Number 10, Mr Blair is not inclined to dismiss this as merely the meddling of tiresome clerics. He believes implicitly in the guidance to be found in the gospels. He appointed Mr Williams knowing, even hoping, that this was an archbishop who would relish engaging him in theological and intellectual debate. Nor could Mr Blair have expected Mr Williams, an inveterate peacenik and anti-nuclear campaigner, to give him an easy ride over Iraq. Yet what must disappoint him is the banality that has characterised at least some of the priestly criticism that has come his way.

For all Mr Williams's formidable intellectual reputation, it is the prime minister who gives the impression of having thought more deeply and agonised more thoroughly about these difficult issues. It would not be

surprising if his copies of “The City of God” and the “Summa Theologica”—the texts for “just war” theory—are at least as well-thumbed as the archbishop's.

The truth is that when it comes to Iraq, the just war arguments are very finely balanced. Just war theory says that war can only be waged as a last resort; by a legitimate authority; with a reasonable chance of success; to re-establish peace; in proportion to an injury suffered; and it must discriminate between combatants and non-combatants. There is room for arguing all these points—whether, for instance, Saddam Hussein poses a sufficient threat to peace, and whether the last resort has been reached. The case can be made both for war and against it; but the clerics are in no better position than Mr Blair to make that judgment.

The most that religious leaders should demand of politicians who are charged with the duty of making terrible decisions is that morality should underpin their thinking. On that basis, it is difficult to see how Mr Blair can be faulted. In foreign affairs, Mr Blair shows an extraordinary disregard for the cynical calculations of realpolitik. Sierra Leone, Kosovo, Afghanistan and now Iraq have convinced him that there are circumstances in which the use of military force to achieve a noble end is not just an option, but a moral obligation.

The strength of Mr Blair's position is that he argues from first principles. The weakness of the clerics' is that they have become sidetracked by their conviction that the United Nations is the sole fount of authority and legitimacy. Mr Blair needs no convincing of the political desirability of a UN resolution explicitly mandating the use of force, but he is right to question why this should alter the moral equation, which is surely all that the churches should concern themselves with.

The UN is what it is—a place where diplomatic horse-trading is conducted and states manoeuvre to secure their national interest. The position it takes on an American attack will probably be determined by whether or not the Mugabe-fêting president of France decides to wield his veto. That, surely, cannot be a measure of morality.

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Ahold

Europe's Enron

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EPA

The Ahold financial scandal should shock Europe into accounting and corporate-governance reform, just as the Enron scandal did America

IT MAY seem an exaggeration to describe the scandal overwhelming Royal Ahold as “Europe's Enron”—but in most of the ways that matter it is true enough. Certainly, the world's third-biggest food retailer, after Wal-Mart and Carrefour, poses none of the systemic financial risks of Enron, which was both deeply in debt and the world's main electricity market-maker. That apart, the similarities between the former Texan powerhouse and the Dutch retailer are striking, from vain yet secretive bosses to the woeful corporate governance, aggressive earnings management and accounting “irregularities” to auditors who were, at best, asleep on the job.

Now, at least, Europeans should stop smugly believing that corporate malfeasance is an American vice that cannot occur in the old continent. Instead, they should fix their corporate-governance and accounting problems with as much vigour as their American cousins showed after the Enron wake-up call.

On February 24th, Ahold announced the resignation of its chief executive and finance director after finding that it had overstated its profits by more than $500m (*euro*463m) in the past two years. Its market value plunged by 63% that day, to *euro*3.3 billion. In late 2001, it exceeded *euro*30 billion. Ahold is now under investigation by various authorities, including America's Securities and Exchange Commission (SEC).

This dwarfs previous accounting scandals in continental Europe; those at Comroad and EM.TV of Germany, and Belgium's Lernout & Hauspie, say, were tiny and mostly involved younger firms. Ahold is 115 years old, with sales estimated (before the scandal) at *euro*77 billion in 2002.

Rather like Kenneth Lay at Enron, and Dennis Kozlowski at Tyco, another scandal-hit American firm, Ahold's now-departing boss, Cees van der Hoeven, won a formidable reputation from turning a dull company into a growth machine. Investors applauded long after they should have started asking hard questions. When eventually they did ask them, he scorned them for daring to doubt him. Eric Tibi of UBS Warburg calls the defensive response of Ahold's bosses to probing questions “incredible—an attempt to frighten us.”

Food for thought

If there is no evidence that he was paid outlandishly—still less that he “looted” the firm, as some American bosses are alleged to have done—Mr van der Hoeven certainly became addicted to his reputation as an infallible corporate titan. He has bought some 50 firms for a total of *euro*19 billion since 1993, and notched up 23 quarters of double-digit profit growth in a row; but when growth slowed, he seems to have been unable to admit to Ahold's true condition. Like many American firms during the bubble years, Ahold started to bend the accounting rules, claiming profits of acquired firms as “organic growth”, booking capital gains from sale-and-leaseback deals as profit, and keeping billions in debt off its balance sheet.

These techniques, though not illegal, should have rung investors' alarm bells, just as Enron's use of off-balance-sheet vehicles should have done. Indeed, some observers were disturbed by them. In June 2001, the Centre for Financial Research & Analysis in Maryland published the first of six reports detailing questionable accounting at Ahold, going back to 1999. Enitan Adebonojo, an author of the reports, argues that such use of smoke and mirrors suggests that the accounting problems at Ahold are far deeper than those revealed this week. Most observers suspect that Ahold has more bad news to reveal.

Although this week's plunging share price suggests that investors were surprised by Ahold's accounting woes, by February 2002 many analysts were questioning the firm's numbers. Yet Mr van der Hoeven continued to assert for much of 2002 that it was on course for double-digit profit growth—promises that may now form the basis of class-action lawsuits.

By February 2002 many analysts were questioning the firm's numbers

The $500m overstatement is due primarily to Ahold's US Foodservice unit, which supplies food to schools, hospitals and restaurants—although there are also issues over its Disco subsidiary in Argentina and several other units. This has led some observers to say that this is less a European problem than yet another American accounting failure. Such an outlandish claim absolves Ahold's bosses of responsibility for their acquisitions and ignores the persistent, firm-wide tendency to test the limits of acceptable accounting.

Most firms that buy in bulk—including such admired retailers as Wal-Mart and Tesco—get discounts from suppliers if they meet sales targets. The issue is how those rebates are accounted for. The prudent practice is to wait until the targets are met. Failing firms, such as now-bankrupt Kmart, Fleming, a food distributor, and now Ahold appear to have booked these payments before they were earned. Ahold may even have booked entire rebates as profit in the first year of multi-year agreements—or simply made them up.

The scandal should dispel claims about the supposed inherent superiority of continental Europe's two-tier boards over Anglo-Saxon unitary boards. Ahold's supervisory board was at least as dominated by Mr van der Hoeven as any American board was by its chief executive. And if nobody should be surprised at lax accounting oversight in the Netherlands, what of Deloitte & Touche, Ahold's auditor? Although Deloitte uncovered the problems in the past few weeks, it should have done so much earlier, says Lynn Turner, a former chief accountant at the SEC. The truth may not be clear for some time. Nor will how much top management knew—a question that remains unanswered for many of the recent American scandals, including Enron. Asked if Ahold and its suppliers might have collaborated to conceal the truth, Deloitte says only that “we would like to know the answer to that too.”

Having wisely negotiated a new *euro*3.1 billion credit line with five banks over the weekend, before publicising its accounting problems, Ahold's short-term liquidity looks assured, despite a downgrade to junk status by Standard & Poor's. But with net debt of at least *euro*13 billion and a market value less than *euro*3 billion, it will have to renegotiate its borrowings soon. There is every chance that it will have to break itself up. One thing at least seems certain: long after the corporate vultures have finished fighting over Ahold's bones, the reverberations of Europe's Enron will be felt by all the old continent's companies.

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American telecoms policy

The FCC presses auto-destruct

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The feud goes on at the FCC

TELECOMS types in Washington, DC, are still struggling to make sense of bizarre events at the Federal Communications Commission (FCC), the industry's regulator. On February 20th, the FCC's five commissioners voted on what was billed as the most important bit of rulemaking since the 1996 telecoms act. But a tiff between the chairman, Michael Powell, and a fellow Republican commissioner, Kevin Martin, left Mr Powell penning a florid dissent to his own commission's ruling, as Mr Martin joined with two Democrat commissioners to pass a rival proposal.

America's telecoms firms are puzzled by the rules that emerged from the chaos. The big local phone companies—the “Baby Bells”—said they would sue the government: unsurprisingly, as Mr Powell's dissent reads like an invitation to do just that. Smaller, financially weaker carriers such as Covad could only marvel at the government's vandalism. The first time Covad heard of a rule change that could kill half its business was on the night before the FCC's decision. Its share price has duly collapsed.

The fate of Covad, which sells broadband connections, is especially upsetting. FCC sources indicate that, of the five commissioners, only Mr Martin wanted to scrap the rule that makes the Baby Bells share the parts of their copper lines which broadband carriers such as Covad use to carry high-speed data. The partnerships that Covad has recently struck with AOL and AT&T to provide broadband for their customers were at last shaking up cosy pricing in the industry, which the Baby Bells and big cable firms mostly divide between them. Oddly, nobody even lobbied to get the rule changed. But Mr Martin said that it was not necessary, as there was enough competition already in broadband. As part of the horse-trading with his new Democrat allies he got his way.

Mr Martin was also behind a decision that devolves responsibility for other FCC rules to the 50 state public-utility commissions. These rules govern which bits of their copper networks the Baby Bells must lease at a discount to firms wanting to offer competing voice services. Mr Martin argued that the states have a right to make their own decisions. Mr Powell countered that devolving this decision to the states would produce a chaotic patchwork of state-by-state rules and a deluge of lawsuits, adding to uncertainty and hitting investment. Mr Martin's chief ally was AT&T. The Bells will now have to lease out all of their networks, at prices which produce fat margins for AT&T. Mr Powell's rule would have made AT&T build some of its own facilities. Now it keeps its fat margins as the industry sinks into chaos.

Some pundits expect Mr Martin to replace Mr Powell as chairman shortly. It is to be hoped that he will not. At best, Mr Martin is unpredictable. A less charitable view is that, in a personal feud, he knifed his chairman by forming an unprincipled alliance, with unpleasant side-effects for years to come. At least Mr Powell cuts a noble—if somewhat tragic—figure, sticking, as others abandon him, to policies he believes in.

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3G in Europe

The ultimate test

Feb 27th 2003
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Now that 3G phones are finally in the shops, does anyone want them?

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FORGET the *euro*100 billion ($108 billion) shelled out by Europe's mobile-phone operators for third-generation (3G) licences. Ignore the debts, the languishing share prices and the endless wrangling over licence terms. Never mind that several would-be 3G operators have quit the market. None of it matters to the shoppers who can now see 3G phones available for sale on the high streets of London, Birmingham, Rome and Milan. Admittedly, these new phones—which can send and receive live video—are only being demonstrated and will not be delivered until later this month. Now that 3G has finally arrived in Europe, will anybody buy it?

All eyes are on Britain and Italy, where Europe's first commercial 3G networks are being launched by 3, a new operator backed by Hutchison Whampoa of Hong Kong. 3 has signed up 140,000 customers in Italy and a similar number in Britain. Unsurprisingly, 3 is emphasising the unique video capability of its 3G handsets.

Visitors to 3's gleaming new shop in London's Oxford Street this week certainly seemed impressed. A survey by The Thinking Box, a consultancy, found that most consumers were amazed to hear that mobile videophones, far from being science fiction, would soon be on sale. Unlike other fancy 3G services, such as help to find a nearby cashpoint or pizzeria, video-telephony is simple and intuitive, says Christophe Cauvy of The Thinking Box.

Yet although video-telephony looks good in advertisements, says Paul Lee, an analyst at Deloitte Consulting, it is hard to imagine who will use it regularly. Take-up in Japan, where video-telephony has been available since October 2001, has been poor. 3's pricing, which offers large bundles of voice and video minutes at *euro*85 or *euro*140 per month, is designed to tempt heavy users away from their existing operators. 3 may thus poach some high-spending customers in the short term. Only when prices fall will it be possible to tell if video-telephony has sufficient mass appeal to justify the huge investment in 3G.

A more cautious approach is being taken by established operators that, unlike 3, have millions of customers using 2G networks. Rather than make a song-and-dance about 3G, Vodafone and T-Mobile are promoting mobile data services, under the brands “Vodafone live!” and “t-zones” respectively. These services, including news updates, games and the ability to send still photos (but not video), are now delivered using enhanced 2G, or 2.5G, networks. But the capacity of 2.5G networks is limited. As more subscribers sign up, the operators will quietly switch users over to 3G. “People will be using 3G without being aware of it,” says Ben Wood of Gartner.

In short, whereas 3 is pushing 3G as revolutionary, to lure subscribers from rivals, the incumbents see it as evolutionary, as they try to keep them. The 3G hype of a couple of years ago is gone and a new pragmatism is abroad in the industry.

What if most consumers decide that voice calls and text messaging are enough, and shun the other new services on which 3G is predicated? Operators would have to fall back on 3G's ability to carry voice calls in higher volumes, and at lower cost, than 2G networks. “Voice is not a market to be sniffed at,” says Mr Lee. Even ten years from now, he says, mobile voice revenues will exceed data revenues. The mobile operators will then set about cannibalising the fixed-line voice business. It would be quite a come-down for a technology that was once expected to change the world. Those vast licence fees may never be recouped. But 3G is coming: it is up to consumers to decide what to do with it.

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The flying internet

Only connect

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Coming soon to a jumbo-jet near you: broadband internet access in the sky

MANY travellers see a long flight as a welcome escape from the office and what E.M. Forster called “the world of telegrams and anger”. Not for much longer. On February 18th British Airways began a three-month trial on flights between London and New York offering interactive broadband connections in the air, using a satellite-based system called “Connexion by Boeing”. A specially adapted 747 now lets passengers use e-mail and surf the internet. A trial by Lufthansa began in January, winning early praise. Japan Airlines and the SAS group will be next.

This week Airbus and Tenzing, a specialist telecoms firm in which the European aircraft-maker has a stake, launched a new version of a rival service that aims to do some of what Boeing's Connexion offers, but at a fraction of the price to passengers and airlines. It takes high-speed satellite radio links already installed on many newer aircraft and uses new equipment from Rockwell Collins, an American avionics firm, to upgrade the signal. There could be further competition if Matsushita, one of the leading providers of inflight entertainment equipment, enters the fray.

According to Boeing's market research, six out of ten passengers are “very interested” in the possibility of staying connected to the office and the corporate network in flight. If its trials go well, Boeing expects to fit and operate the service across BA's and Lufthansa's long-haul fleet. Boeing struggled for years to launch broadband, after converting in-house military antenna technology to civilian use.

Two years ago, the cheaper, narrowband connectivity of Tenzing's service seemed likely to triumph. Airlines such as Singapore, Cathay Pacific and Virgin Atlantic signed up for it. Now Boeing is the more bullish. In ten years, passengers using Boeing's service could be spending $10 billion annually—$30 a flight—with half going to Boeing, says Scott Carson, boss of Connexion. To do this, the service would need to be installed on about 4,000 planes. Boeing aims to win 60% of the market. The latest upgrade of the Tenzing service will cost $10 a flight, aiming to regain the lead from Boeing by costing less. Both will allow live surfing and e-mail, but Connexion will be faster and able to handle video images.

Some sceptics note that if passengers could use mobile phones hooked to laptops, that might appeal more to them than fancy in-flight broadband connections for which they would have to pay. But that day is not in sight. Mobile-phone use is banned on flights not just because of worries that it might interfere with flight systems (not likely, in fact): neither the airlines nor the phone firms like the idea.

The airlines fear that many passengers would avoid flights where the person in the next seat might talk endlessly into a handset (“I'm on the plane”)—one reason why they charge so much to use seat-back phones. The phone companies do not like calls from aircraft because a signal coming down from 35,000 feet spreads out to reach many different cellular base-stations and risks jamming the whole system. Boeing says it has no plans to offer voice telephony on Connexion, though it might provide phone boxes, away from other passengers, on bigger aircraft.

The airlines increasingly see broadband as a way of luring passengers from other carriers, while providing a useful extra source of income. Passengers could shop online for duty-free alcohol, with the airport shop bringing the bottles to the gate on arrival, not departure. This would save the chore of carrying heavy bottles at both ends of the flight. Removing duty-free trolleys and bags of carry-on booze would also trim the weight of aircraft, thus helping to save fuel. Michael O'Leary, the boss of Ryanair, is considering using the online service to screen live TV on seat-back screens, paid for by passengers swiping their credit cards.

But the real clincher for airlines is that the satellite link can also boost operating efficiency. Aircraft could

be wired to allow workers on the ground to keep a constant watch on their health. Early warning would be given of problems. As well as enhancing safety, engineers would, say, be alerted fast to a part showing early signs of wear. That would mean fewer cases of unscheduled maintenance grounding planes, so aircraft utilisation could rise. As Forster also said, “Only connect”.

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Airlines

Buzzing off

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Low-cost airlines meet growth problems

RYANAIR is closing buzz, its newly acquired airline, for a month in April and shedding two-thirds of its staff. EasyJet's shares fell by 12% after it admitted to lower yields in recent months. Doubts are growing over whether it will exercise its option to buy DBA, a German subsidiary of British Airways (BA). Are the woes of aviation now hitting even the low-cost airlines which, in Europe and America, have so far escaped the pain afflicting the big network carriers?

Not really. The easyJet share slide, along with falls in BA and KLM shares, reflects investor anxiety about the impact of a war in Iraq on airlines, rather than worries that the low-cost model is losing its magic. Nor is buzz's closure a reduction of capacity to meet falling demand, even if it looks like it.

Ryanair, an Irish-based low-cost carrier, bought buzz from KLM last month for just *euro*5m ($5.4m) net. But the airline is losing *euro*1m a week. The closure aims to impress upon pilots and the rest of the workforce that Ryanair's boss, Michael O'Leary, means to force through new working practices to boost productivity: pilots, for instance, will have to work more hours per month.

But more than that, Ryanair plans a complete makeover for buzz. Out will go its uneconomic old BAE146 jets. In will come bigger, more efficient Boeing 737s—still the workhorses of low-cost carriers (though easyJet is switching to Airbuses). Out too will go routes and flights that do not generate enough traffic to fill larger aircraft. Many buzz destinations are small provincial French towns. Mr O'Leary wants to renegotiate the landing deals. He believes in being paid by such airports, not having to pay landing fees. Those airports that do not play Ryanair's game will lose flights.

As for easyJet, by flying into big airports it competes more with network airlines, such as BA and Lufthansa, which now offer low fares at off-peak times over the internet. Charter airlines are also competing by offering scheduled flights. But easyJet's yields would not have fallen so far without a near-40% rise in its capacity after it bought Go, formerly BA's low-cost carrier. EasyJet's business model requires high load-factors of over 80% because, unlike Ryanair at secondary airports, it has to pay relatively high landing fees. To reach its load target, it has had to cut fares—hence its lower yields. Still, a timely reminder that even low-cost airlines have their limits.

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The music industry

In a spin

Feb 27th 2003
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The record industry is desperately seeking a way out of its problems

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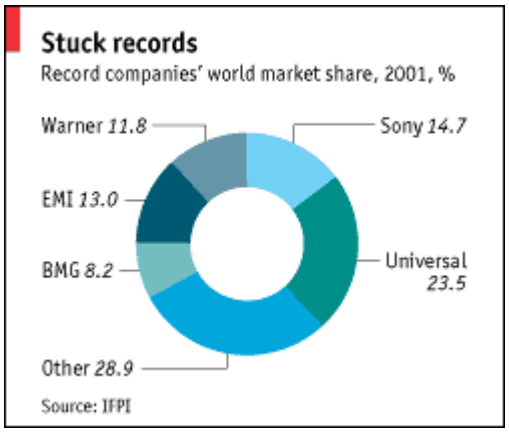
Reuters

Norah comes away with eight Grammys

HAVING failed to squelch digital piracy, can the record industry merge its way out of trouble? That question has been around since late last year when EMI, the world's biggest independent record company, is said to have begun talks to revive two old merger ideas. In time, some expect the five big companies to become three.

Piracy remains the biggest headache. The record industry has squashed Napster in the courts, but other online music-swapping services have sprung up in its place. File-sharing on KaZaA was 1,491% higher in June 2002 than in June 2001, according to ComScore Media Metrix, a research group. The industry is suing this and other file-sharing services, but new ones emerge as fast as old ones are shut down. Little wonder that sales of recorded music dropped in 2002 by an estimated 9%.

In this shrinking market, the savings that might be squeezed from a merger offer a lifeline. In the past, European regulators have been an obstacle, repeatedly blocking mergers among the big five record companies—Vivendi's Universal Music, Sony Music, EMI, AOL Time Warner's Warner Music, and Bertelsmann's BMG—which between them control 70% of the global recorded-music market. In 2000, they blocked a merger of Warner and EMI by imposing heavy divestment conditions. They stopped EMI marrying BMG even before a formal proposal was tabled.



In its present state, the record industry may get a more sympathetic hearing; and Brussels, having lost several court cases over mergers, is less obstructive. Though talks are preliminary, and the BMG option is not ruled out, EMI is more likely to do a deal with Warner. The two firms complement each other: EMI is strong in Europe and weak in America, Warner the opposite. Alain Levy, EMI's boss, has streamlined his firm, but savings from a merger could still reach about £150m ($240m), says Brett Hucker of Merrill Lynch.

There remain obstacles to a deal, however. AOL Time Warner, under pressure to pay off debt, needs cash, but this could be hard for EMI to provide given its own large debts. There would also be awkward negotiations about who would run the combined firm. Mr Levy, who has cut the flab and curbed the extravagance at EMI, would resist ceding any control. Regulators might quibble over combining their music-publishing operations.

Consolidation is but one of three strategies that the industry hopes will help it survive as it works out how to beat the pirates. A second is a renewed effort to rely less on instant stars and more on long-term talent. Overnight stars can fade as fast as they are born. Hear'Say, a British band assembled by a TV talent show two years ago and signed to Vivendi Universal's Polydor, went straight to number one with its first album; now, the band has split up. EMI, by contrast, launched Norah Jones, a singer who blends

country, folk and blues, a year ago. Her first album, “Come away with me”, took 46 weeks to top the American charts; at this week's Grammy ceremony, she won eight awards.

A third idea is to transform narrowly defined record firms into broader music companies. Revenues from touring, concerts, sponsorship and so on added about 40% to global sales of recorded music in 2001, making the global music industry worth $47.6 billion, according to a recent report by *Music Week*, a trade title. Some new sorts of music revenues are emerging: sales of snatches of songs to use as mobile-phone ring-tones raised $71m last year for artists, according to Informa Media, a research group—small, but 58% up on 2001.

For a true star, the extra pot is far bigger: record companies get only 15% of all revenues generated by such an artist, although they have made the star's name and marketed his brand. The rest goes to the singer, agent, manager, producer and assorted other hangers-on. Although only such mega-stars as Eminem or Christina Aguilera pull in serious money from such activities, they represent a handy pot which, at the moment, the record companies have no fingers in. Now, they are trying to rectify this. The apparently extravagant recent record deal between EMI and Robbie Williams was a bid by Mr Levy to reorient his company in this way. The deal, in effect, gives EMI a stake in Robbie Inc and in all his future earnings.

But even if the industry buys itself time through consolidation and other strategies, its long-term health requires a solution to piracy. Investing in musicians is ultimately about building a back catalogue of hits that provide an ongoing source of revenues. But what is the point of a back catalogue if pirates are helping themselves to its tracks for nothing? If that is the outcome, the winners from today's merger talks could simply be the sellers.

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Hollywood and the war

Big-screen pacifiers

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From The Economist print edition

Will anti-war protests by the stars harm Hollywood?

HOLLYWOOD stars were busy again this week, denouncing George Bush and the war. They slipped in the odd condemnation at the British film awards, despite the BBC's broadcast delay designed to edit such stuff out. Martin Sheen, who plays a fictional American president in “The West Wing”, launched a “virtual march” on Washington, in a bid to jam senators' phone lines with anti-war protests. On March 23rd, more actors will add to the chorus at the Academy Awards. Scores of Hollywood stars, from Matt Damon to Helen Hunt, have joined “Artists United to Win without War”, signing a letter declaring that “a pre-emptive military invasion of Iraq will harm American national interests”.

Such anti-war posturing, at odds with the studios' staple jingoistic output, has a long tradition in Hollywood. Jane Fonda was dubbed “Hanoi Jane” for her anti-American efforts in Vietnam. This year, the Academy has no plans to gag stars at the live broadcast, although Tim Robbins and Susan Sarandon have been scolded in the past for condemning American foreign policy. There are worries in some quarters, however, that outspoken anti-war preaching by the stars could harm Hollywood.

Miramax, owned by Disney, has delayed the release of two war films with anti-American undertones. “The Quiet American”, a remake of Graham Greene's novel set in Vietnam, was temporarily shelved after the 2001 terrorist attacks: “You can't release this film now,” Harvey Weinstein, Miramax's co-head, said at the time.“It's unpatriotic.” Miramax has delayed the release of another film, “Buffalo Soldiers”, an anti-military satire, now due for limited release in May.

There are strikingly few testosterone-laden American military movies due out. Two from Sony are “Tears of the Sun”, starring Bruce Willis, and “Basic”, directed by John (“Die Hard”) McTiernan. In the second world war, Hollywood mobilised a full war-supporting production slate; in today's global market, the industry is marked by a mix of ambivalence and a commercial sense that American patriotism does not sell.

As Dade Hayes of *Variety*, a Hollywood paper, argues: “American tastes have shifted significantly since the heyday of Schwarzenegger, Willis, Stallone et al.” This year's releases are mostly comic-book films (“The Hulk”) and sequels (“The Matrix Reloaded”), not gun-toting machismo. Europeans seem as happy to lap up that sort of Americana as ever. The top box-office film in France and Germany for much of February has been “Catch Me If You Can”, by that Hollywood icon, Steven Spielberg.

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Auction houses

Just the two of us

Feb 27th 2003
From The Economist print edition

The duopoly in fine-art auctions is weakened but very much alive

Get article background

ALFRED TAUBMAN is still in jail in Rochester, Minnesota, but he is already planning life after his release. On February 21st, his family shelved its planned sale of a majority stake in Sotheby's, one of the two leading auction houses for fine art. After serving his sentence, reduced from a year and a day to ten months and two weeks, for his part in a price-fixing scandal, Mr Taubman will be free in May. Rumours abound that the former chairman of Sotheby's will reclaim his old job.

“We have absolutely no indication that Mr Taubman will be involved in the affairs or the management of the business when he comes back,” says William Ruprecht, chief executive of Sotheby's. But Mr Taubman controls 22% of the company's capital and 63% of the voting rights. He can appoint some members of Sotheby's board, now full of titled folk, financiers and retired ambassadors.

Like his counterpart at Christie's, Mr Ruprecht wants to draw a line under the past three years. In 2000, Christie's and Sotheby's agreed to pay $256m apiece to compensate clients for illegally co-ordinating the commissions they charged on sales. Mr Taubman paid $156m of Sotheby's bill; the firm paid $100m. Sotheby's was also fined $45m by America's Department of Justice (DOJ) and $20m by the European Commission. Christie's won exemption from the DOJ and EU fines by spilling the beans on the price fixing.

As if that were not bad enough, Sotheby's and Christie's found themselves under attack from an interloper. In 1999, Bernard Arnault, head of LVMH, a French luxury-goods conglomerate, bought Phillips, a smaller auction house, with the aim of breaking the duopoly at the top of the market. Phillips aggressively bought market share, mainly by giving sellers lavish guarantees, promises to buy their art at a pre-agreed price if the bidding failed to go high enough—and so won the sales of many coveted collections that would otherwise have gone to Christie's or Sotheby's. All this was painful for the big two.

In December, Sotheby's even sold its grand Manhattan headquarters for $175m to RFR Holding, a property firm, and leased it back for up to 40 years. It cut annual operating costs by $70m in the last two years. Staff numbers were chopped from 2,100 to 1,800, with more job losses likely. Earlier this month, Sotheby's abandoned its partnership with eBay after it lost $100m through its various attempts to sell fine art over the internet. Christie's has also cut staff, by some 15% since 2001, to around 1,900. Like Sotheby's—but presumably entirely coincidentally—it raised its commissions at the start of the year to strengthen its balance sheet.

“We have now put the vast majority of our legal troubles behind us,” says Mr Ruprecht. They have also put Phillips behind them—which may have made it easier for the reborn duopoly to raise their commissions. Having lost all of Mr Arnault's financial support in January, Phillips is to fire half its staff and close all but four of its auction departments: it is hanging on to contemporary art, American paintings, 20th-century design, and jewellery.

Yet prospects for Sotheby's and Christie's remain tough. Moody's, a credit-rating agency, continues to regard Sotheby's debt as junk. (As Christie's is a private firm, its finances are more opaque, but probably not much better.) Buyers have started to dwindle due to declining wealth after the stockmarket-bubble burst and fear of war. Nobody who does not have to wants to sell into what is now a buyers' market.

How strong a link there is between art and the stockmarket is much debated. Certainly, the art market has remained buoyant long after the stockmarket crashed. Mr Ruprecht thinks that high-quality art tends

to be more stable than most financial investments. When rare art comes to the market it is a once-in-a-lifetime opportunity, he argues, and people always buy. Rubens's “Massacre of the Innocents”sold for a record-breaking $77m at Sotheby's last year.

William Goetzmann at Yale School of Management has subjected the art market to econometric analysis, and found that the art market's “beta”—its synchronised movement with the stockmarket—is higher than one. This means that in boom times art moves up more, and in crashes art drops lower. But the effect is lagged, he says; so the real pain in the art market may still lie ahead. So if Mr Taubman does return to his old job in May, he may find he has his work cut out. Still, it beats jail.

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Drugs

Cost of living

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Why do some drugs cost so much?

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ANY drug that might save your life would be worth its weight in gold. Or 27 times its weight in gold if the drug in question is Fuzeon, a new medicine to fight HIV. This week Roche, a Swiss drug firm which co-developed the product, announced that it would charge *euro*18,980 ($20,000) in Europe for a year's worth of therapy—or roughly *euro*290 per gram. This price tag has rattled government agencies and private insurers, in rich and poor countries alike, which face a hefty bill for the thousands of patients who might benefit from the drug.

While Fuzeon is the most expensive AIDS drug yet, it is cheap compared with some other pharmaceuticals, particularly the fruits of biotechnology. Next week brings the European launch of Zavesca—a drug to treat a rare, deadly disorder called Gaucher's disease—developed by Oxford Glyco Sciences, a British biotech firm that is now the subject of a bidding war between Celltech and Cambridge Antibody Technology. Zavesca will start at around $100,000 for a year's treatment.

What makes such drugs so expensive? Consumer groups argue that greed is largely to blame, and that drug firms are raking in excess profits. But people in the industry argue that prices are high largely to cover the cost of research and development—a figure which ranges from tens to hundreds of millions of dollars, depending on the product in question and whose estimates are to be believed.

When it comes to high-end biotechnology drugs such as Fuzeon, much of the price simply covers the cost of manufacture. Unlike conventional pharmaceuticals, medicines made of proteins or other biological molecules can be extremely complex to make, often using expensive raw materials or live cells to churn out a product that must then go through elaborate purification. Genzyme, an American biotech firm, reckons it spends roughly $150m a year on manufacturing Cerezyme, its drug to treat Gaucher's disease—which it then sells for roughly $170,000 for a year's therapy.

As Frank Lichtenberg, an economist at Columbia University, points out, perhaps the biggest determinant of a drug's price is how buyers choose to value it. Newer medicines, which keep people alive and working or reduce overall medical costs, may be able to command a sizeable premium in the market. Companies such as Genzyme spend considerable effort and money talking to public and private insurers about the potential cost savings they would make by purchasing such expensive drugs. Mr Lichtenberg's own research suggests that roughly 40% of the increase in life expectancy seen in 52 countries between 1986 and 2000 is due to the launch of new medicines in this period. Although the high price of high-tech drugs may startle many people, the alternative is no less shocking and much less healthy.

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The fur trade

Puppy love

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How much is that dead doggy in the window?

CAT PELTS, a golden-retriever rug and a full-length coat made from 42 German shepherd puppies make the office of Struan Stevenson seem like a set from a dark version of “101 Dalmatians”. But this is not proof that the British Conservative MEP is a modern Cruella de Vil. It is evidence in his campaign for a European Union ban on trade in cat and dog fur. Each item was bought in a big European city, he says.

Three years ago, revelations that what are usually regarded as family pets are being bred by the million—mostly in China—for the fur trade, provoked America's Congress into passing the Cat and Dog Protection Act. According to America's Humane Society, which highlighted the trade, the focus of exports is now Europe, where fluffy cat and dog skins now account for a large number of coat trims, snow-boot linings and hairbands in even the most respectable mainstream shops—with consumers, and probably the shops themselves, blissfully unaware that they are buying and selling ex-Rovers and Felixes.

The thought that consumers might start to wonder if that mink (nasty creature, deserves to die) is really a cute domestic moggy (ahhh!) is the last thing the rest of the fur trade needs now. It is growing steadily again, despite the best efforts of campaigners to make wearing fur socially unacceptable: remember the ads featuring models saying they would rather go naked than wear fur?

Which is why, although the EU seems unlikely to copy America's outright ban, the “respectable” fur trade will do all it can to stamp out imports of cat and dog. Members of the International Fur Trade Federation (IFTF) already have a self-imposed ban on cat and dog fur. Next September, the IFTF will introduce stricter labelling, showing the source of fur in English, the local language and Latin. Will that beat labels such as “Asian wolf” and “Dogues du Chine” that are now used?

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Face value

McKinsey's election battle

Feb 27th 2003
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Can Ian Davis or Michael Patsalos-Fox restore McKinsey to its former glory?

AS ELECTIONS go, the process of choosing a new managing partner for McKinsey, the world's best-known management consultancy, is particularly rum. For one thing, it is a studiedly polite affair. The candidates—there were seven, but now just two remain—issue no manifestos. Canvassing is considered to be bad form and is therefore counter-productive. This makes knowing what particular individuals stand for rather tricky.

Moreover, the firm (or, as insiders call it, the Firm) is itself at pains to play down the importance of the election. It refuses to talk openly about it, let alone to share insights into personalities or issues. Normally chatty McKinsey partners clam up when asked about the race. Junior staff know it could harm their careers if they were heard gossiping. So the election takes place in an atmosphere of near-Trappist silence. How on earth do the 280-odd partners who vote make up their minds?

Decide they must. Next week McKinsey will announce whether Ian Davis, head of its London office, or Michael Patsalos-Fox, who runs New York, will be its new boss. Both ran three years ago, when Rajat Gupta was eventually re-elected for a third and final term. Mr Gupta's long stint saw big changes at McKinsey, notably greater enrichment of partners relative to up-and-coming associates and a belated rush to join the “new economy” boom. McKinsey is still dealing with the after-effects of a hiring spree in the late 1990s that tested the ability of its culture to absorb large numbers and also created unprecedented tensions when lay-offs followed the pricking of the technology bubble.

Whichever man McKinsey chooses, it cannot avoid some awkward questions. One is whether it wants to be a global firm, or is just an American firm with a series of regional outposts. Already some big offices are relatively independent. McKinsey's successful German arm, for instance, has long cultivated separateness; its French operation has done less well. But at the heart of the tension is America, where over-hiring was greatest and retrenchment has proved most painful. Under Mr Gupta, an American though originally from India, most of McKinsey's managers have also been American. But, say insiders, he has proved the adage that good consultants do not necessarily make good managers. One way to make the firm more global would be to reform its management structures, breaking up the New York-based cabal and bringing in fresh blood from elsewhere.

Mr Davis is an affable Brit who wears his ambition lightly but is deeply committed to the firm's traditional

values, in particular the need to invest in long-term relationships with clients and to nurture the associates who represent the firm's future. Although it expanded when others did, the London office has escaped the worst of the bad times, in part because Mr Davis insisted that programmes to train and help associates should not be cut. Were he to win, Mr Davis could instantly shift the firm's centre of gravity by choosing to run it from his base in London.

Mr Patsalos-Fox, Greek-Australian by origin but also an alumnus of London, is the first non-American to run New York. That is no mean achievement. He landed the job after a stint in New Jersey, having lost out to Mr Davis for the top job in London. He is harder-charging and more ruthless than Mr Davis. One of his first steps after taking over in New York was to try to raise poor morale, but not everybody thinks he has succeeded.

Perhaps the biggest challenge facing McKinsey is whether it can recapture its mystique—the reputational edge that, to the chagrin of such competitors as Bain and Boston Consulting Group, once meant it was mentioned in a class of its own. This reputation was arguably at its highest in the 1970s and 1980s when McKinsey was the top strategy consultancy, advising chief executives on big trends, sometimes persuading them to reshape entire industries. However, some observers regard its heyday as the 1990s, when so many former partners occupied top jobs outside that the world sometimes seemed to be run by the Firm.

In the 1990s, so many former partners occupied top jobs outside that the world sometimes seemed to be run by the Firm

Over the past decade, the consulting market has changed. Rivals got better at touting strategic advice of their own. And many clients began to care less about bold new initiatives and more about running themselves efficiently, a trend that helped “technology integrators” such as Andersen Consulting (now Accenture). As McKinsey adapted to these changes, so it became less distinctive. Its mystique may not have disappeared, but it certainly diminished.

Strategist, heal thyself

How to reverse that trend? The market is not helping. Clients remain fearful of big decisions of the kind that McKinsey likes to advise on. Instead they want nitty-gritty advice—help with IT or marketing. Big mergers, often favoured by McKinsey in the past, are now seen as too risky by managers concerned to regain the good opinion of their shareholders. So too clever management innovations of the sort urged on Enron, whose ex-McKinsey former chief executive, Jeffrey Skilling, is regarded by some critics as an emblem of what went wrong with McKinsey during the 1990s. McKinsey recently invited George Shaheen, a former boss of Accenture who quit to run Webvan, a failed internet start-up, to address partners. Taking lessons from Mr Shaheen? That worries those who yearn for more mystique.

The managing partner has limited executive power: as one insider puts it, “there wouldn't be much scope for a command-and-control approach here.” But he does have influence, through personality and through the committees and task-forces that McKinsey uses for internal governance. By setting the agenda and hand-picking the leading decision-makers, he can play a big part in shaping the firm's identity. That is why this election is more important than most. Do not be fooled by the polite, low-key tone: next week's announcement will mark a critical moment in the Firm's history.

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Sony

The complete home entertainer?

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Life after PlayStation 2

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SONY seems to have learnt one basic lesson of corporate public relations: messages are better received when you are making money. Little more than a year ago, when the company reported losses of ¥43.3 billion ($354m) in one six-month period, its chief executive, Nobuyuki Idei, was unusually reserved. Grand talk of long-term plans for the future, he said, could wait until the electronics and media giant showed a better command of the present. Now Mr Idei is basking in record sales and handsome profits—in the most recent quarter, net profits nearly doubled, to ¥125.4 billion ($1.02 billion)—and he has seized the opportunity to crank up the volume and talk about Sony's big plans for your living room.

Compared with other large media companies, the Japanese giant has earned some right to brag. Over the past few years, Sony has studiously kept its head down, while the likes of AOL Time Warner, Vivendi Universal and Bertelsmann sought to build ever-bigger conglomerates through mergers and acquisitions. Although the details varied, the idea behind all those deals was to buy new outlets through which the behemoths could push their music, films, news and other media content. The outlets ranged from cable and satellite broadcasters to internet portals, and the excursion has ended in much heartache.

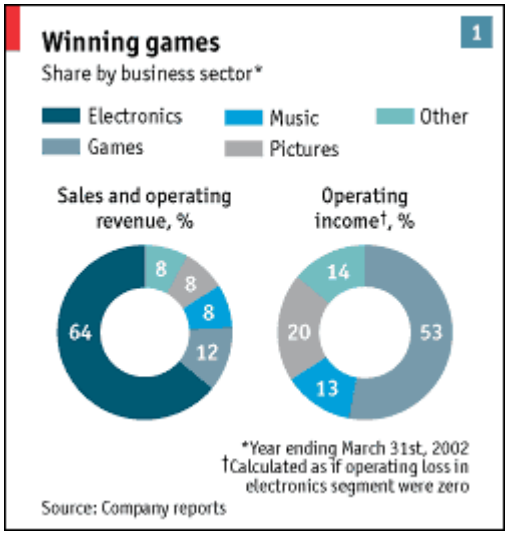
Sony, by contrast, has in recent years largely shied away from big investments through which to push content produced by its Columbia Pictures, CBS Records and PlayStation video-games divisions. It has dabbled in satellite broadcasting in its home market, teaming up with Rupert Murdoch's News Corporation and others in 1997 to invest ¥5 billion in JSkyB. After a couple of domestic mergers, that investment has left it with an 8% stake in SkyPerfecTV, Japan's leading satellite broadcaster. Outside Japan, however, it has resisted the urge to add broadcasters or internet firms to its stable.

Such discretion left the company better able to make a profit from last year's boom in video games, DVDs and trips to the box office. Even as its traditional consumer-electronics business suffered from low-cost rivals, video games accounted for over 50% of operating profits last year—and only 12% of sales (see chart 1).

Home thoughts from a broadband

Sony has gone about things differently. But its ambitions are in many ways even bolder than those of the other media giants. Like

them, it believes that the spread of broadband and the shift from analogue to digital require media firms to find new ways to sell their content to consumers—in Sony's case, mostly music, films and video games. It also believes that in the battle to do this, as the slogan for its 1998 film “Godzilla” put it, size matters.



More importantly, however, Sony is pursuing the other big idea in the media giants' growth strategy: vertical integration. But once again, it is doing it in its own way. The difference is that Sony is reaching much further down the chain, to what Mr Idei believes really matters: the televisions, personal computers, game consoles and hand-held devices through which all of that wonderful content will one day be streaming.

Whatever happens to its media businesses, Sony's first love is still consumer electronics. From video recorders to compact discs, from Walkmans to PlayStations, it has consistently helped to change the way in which people acquire and use media content. The difference now is that Sony does not expect its next breakthrough to come from a single new electronic device. Instead, as Mr Idei and Sony's president, Kunitake Ando, are telling anybody who will listen, the idea is to make a whole range of devices more useful by linking them in a networked home-entertainment system.

The notion that the television and the personal computer will increasingly resemble each other, and talk to a wide range of other devices, is not new. Mr Idei himself has been talking about such convergence since he became chief executive in 1995 when the chairman, Norio Ohga (who retired last month), by-passed more than a dozen more senior managers to give him the job. Having jumped on to the broadband wagon, however, Sony believes that its clout in consumer electronics, combined with its media content, will allow it to steer that convergence in a way that suits it.

Many devices are mentioned in the debate over whether the TV, the PC or something else will matter most. Sony makes every one of them—with a strong brand name that gives them an extra push off retail shelves around the world. To its televisions and DVD players it has recently added a product called CoCoon, an enhanced TiVo-like device that can store televised video or download it from the internet, and that is already selling in Japan. To its Vaio desktop computers and notebooks it has added a new RoomLink device, which can send digital music, photos or home videos wirelessly from a personal computer to other components elsewhere in the house.

Sony's networking strategy assumes that these audio-visual and computer devices, besides talking to one another, will also share content with a wide range of smaller gadgets, from its cameras and music players to its mobile phones and hand-held computers. (Whether people will also want to link these to the likes of Aibo, Sony's puppy-like line of personal robots, is another matter.)

Like other consumer-electronics firms, Sony is already blurring the lines between these gadgets by blending their features. Its newest Clie hand-held computer plays digital music and takes pictures. The 3G phone launched in February by SonyEricsson, its joint venture with the Swedish phone manufacturer, has two built-in cameras, two display units and a video facility. One of Sony's other new devices, the Airboard, is a wireless panel that you manipulate with a stylus. It can be used either to watch television or to send e-mail and surf the internet.

Devices and desires

Mr Idei believes that, by continuing to link together devices such as these, Sony can carry on both selling new gadgets and encouraging people to keep paying for music and videos. The model to follow, he says, will be the PlayStation, which has quickly propelled its video-game business into one of Sony's best sources of profit. In just three years, the company has sold more than 50m of its PlayStation 2 game consoles, compared with fewer than 10m of its main rival, Microsoft's Xbox.

To Mr Idei, however, the PlayStation is more than just another in a long line of successful Sony machines. The ability to network the game consoles (which allows players to gain access to content and play against each other online) points the way towards what he says the company will do with other electronic components. The next version of the consoles, due out in 2005, will be able to do even more than PlayStation 2, in particular by taking far more advantage of broadband internet access. By that

time, Microsoft will be launching the next generation of its Xbox, which could pose much stiffer competition than the original. But in terms of Sony's strategy, that is not the only reason to avoid putting too much faith in the PlayStation.

The bigger drawback is that the game consoles may well remain distinct in consumers' minds from all the other components that will be pumping out music, video and other content, however wirelessly linked those components are to each other. So instead of acting as a handy installed consumer base on to which Sony can snap other networked components, the PlayStation may do no more than serve as a guide, showing Sony what it must aim for in its next—far more difficult—task.

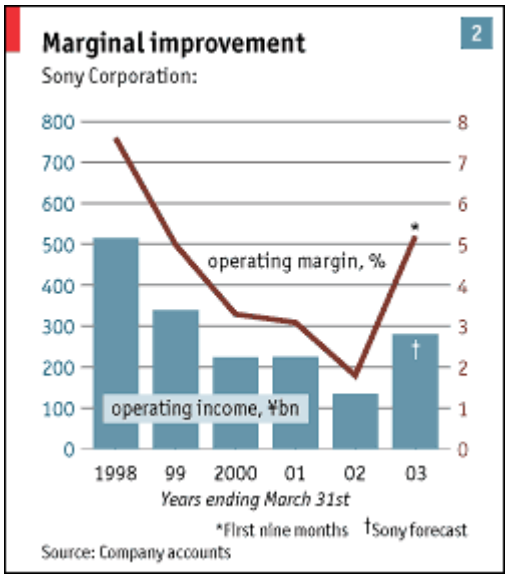
To make something out of all its other devices, Sony must overcome three big obstacles

To make something out of all its other devices, Sony must overcome three big obstacles. The first is that the rest of the consumer-electronics industry is more competitive than the market for game consoles, in which Nintendo is the only other real competitor besides Microsoft.

The second is that the other businesses may find it hard to change their ways. PlayStation was built from scratch by people working outside the company's mainstream. Ken Kutaragi, the driving force behind it, succeeded largely because he teamed up with Sony's entertainment people in southern California. He ignored the electronics team back home in Japan, forged an alliance between hardware designers and creative game-software developers, and created a profitable division that still wants little to do with the rest of the company.

The third obstacle is that, even if the electronics division can find fresh ideas with the potential to turn things round, those ideas might clash head-on with the content side of the business, which is worried about piracy and remains ambivalent about all the promised new devices.

Consider more carefully the competition in consumer electronics. Cheap televisions, DVD players and personal computers are springing up everywhere—one reason why Sony's profit margins have been falling steadily in recent years (see chart 2). Although the past three quarters have seen profits and margins recover somewhat, that may be just a blip in an otherwise worrying trend. Sony is forecasting operating profits of only ¥280 billion for the fiscal year that ends this month, far below the ¥514 billion operating profit that it reported in its record year of 1998. In short, it must not only link all of those clever new devices together; it must do it in a way that other manufacturers cannot imitate cheaply.



Then consider Sony's disappointing record in mobile phones. Although it has teamed up with Sweden's Ericsson, not long ago a leader in the industry, their joint venture has yet to produce a winner. However, its phones (particularly the new P800) are highly regarded by technology enthusiasts. In January, Sony and Ericsson each put another *euro*150m ($161m) into the venture, hoping that the next generation of handsets (which is coming out this year) will turn things around.

The venture's difficulties highlight the challenge that Sony faces in those markets in which the guts of a device are increasingly easy to license. Although the company can still earn money by licensing some of its technologies to others, it must increasingly work in large alliances to make things happen. And those alliances, by embracing so many others, limit Sony's own share of the potential market.

Good Idei

Sony's strong brand and flair for design can still help it out in places. One of its more mundane new devices is the wireless access point that joins components in a local area network and provides access to the internet. These simple devices, which can be found in most computer stores, are usually plain, flat and ugly plastic boxes with thick antennae jutting out. Sony, by contrast, has given its device a glassy, opaque surface, and has stood it up vertically with the antennae out of sight. It can sit comfortably in full view rather than be tucked away next to the desktop in the spare bedroom.

It is getting ever harder, however, to put components in better wrappers and sell them for a higher price. But Sony is not prepared to start competing on price alone. Mr Idei has certainly taken steps to make manufacturing more efficient. Last year, Sony put 12 of its Japanese plants into a single unit to get them to pay more heed to costs. Mr Idei is continuing to move production overseas—including, of course, switching low-cost assembly to China. A recently announced restructuring plan for Sony's Aiwa subsidiary, which makes low-priced electronics, should also yield savings eventually, despite a ¥30 billion charge this year.

Sony will have to pay much more attention to software

Rather than rely mostly on cutting costs, however, Sony hopes that it can continue to make components that will be worth more than its competitors' knock-offs because of their networking features. To make such devices easier to use, Sony will have to pay much more attention to software. Here, despite some co-operation, the company is squarely up against Microsoft. Not only is the Xbox designed to eat into PlayStation's market, but Microsoft is trying to extend its Windows operating system to form standards for a range of other devices beyond the PC—the very ones on which Mr Idei is staking his company's future.

It is not hard to find a pattern in the software alliances that Sony has struck. Its Clie hand-held computer works with the Palm operating system, Microsoft's main competitor in this business, and it has based its plans for the CoCoon and many hand-held devices on another Microsoft foe, Linux, the open-source operating system. Sony's Vaio personal computer is its only important device to use Microsoft software, and that is because, in the PC market at least, it is still difficult to get away from the giant from Redmond.

With so many consumer-electronics, software and other technology firms co-operating to forge an alternative to Microsoft, it will be hard for Sony alone to gain control of the living room. The only way to do it will be to forge closer co-operation among the groups that design Sony's gadgets, and to get them, in turn, to pay more attention to the demands that open-source software will place on their designs.

Yet this leads back to the second obstacle facing Mr Idei. The success story to which he keeps pointing, the PlayStation, became a hit because its developers largely by-passed the rest of the electronics division. If Mr Idei wants to forge new synergies among the rest of the electronics team, he will find it hard if he also wants to follow the example of PlayStation.

Apple is the teacher

With Mr Ohga having just retired, Mr Idei is now sole chairman as well as chief executive, and he seems to be planning more moves to restructure the firm. The company took a bold step in January by announcing that it will organise itself more like an American company, a move that a handful of other Japanese electronics firms are emulating.

Mr Idei has also been saying that he will keep tinkering with the company's management structure, in an effort to tie the geographical regions together and make planning more effective. The gap between the company in Japan and Sony Corporation of America has always been stark, with the music and film people in the United States often at loggerheads with head office in Japan.

And that goes back to the third obstacle facing Mr Idei. Even if he can get all of his clever engineers to work more closely together, get them to pay more heed to the demands of open-source software, and create an array of networked devices that are neither controlled by Microsoft software nor easy for others to manufacture cheaply, he must solve another problem that nobody has a clear idea how to tackle. He must find a way to keep those brilliant devices from wreaking havoc on the media business by encouraging piracy. Looked at from the other direction, he has to stop the media people from holding the rest of the company back.

To see just how big a challenge this is, consider Apple's iPod. This cleverly designed digital music player, which can hold 4,000 songs, links easily to a computer, and also boasts a calendar and an address book, seems like just the sort of path-breaking gadget that Sony itself should be coming up with. That Apple has come seemingly from nowhere to launch the Walkman of the early 21st century has shaken many Sony executives. As one critic puts it, people walking around with an iPod and an Apple PowerBook look much cooler than those equipped with a Clie and a Vaio notebook. For Sony, that should spell trouble.

That Apple knows a thing or two about design is not news. But one reason for the iPod's success is that

Apple, which owns no content businesses, suffers none of Sony's hang-ups about protecting its own digital content. Sony's hang-ups are not imaginary. Piracy is eating into revenues in the music business: global music sales fell by an estimated 9% last year. If networked devices and greater bandwidth eventually do the same to video content, Sony's film business could be among the first to suffer.

The irony is that Sony got into the film business in the 1980s precisely because it wanted the clout to help its electronics business set new standards. Several episodes in the firm's history drove it to this strategy. When it wanted to impose new rules on Japanese record distributors in 1968, it was able to break their backs by threatening to withhold copies of “The Sound of Silence”, a Simon and Garfunkel classic that Japanese consumers had to own and to which Sony had the rights through its joint venture with CBS Records.

In the 1980s, its music collection also played a role in helping Sony to win the CD standards battle. But the episode that made the strongest impression was the one that failed. When Sony's Betamax video recorders lost out to Matsushita's rival VHS player, Sony executives were convinced that a film library could have made a difference—a conclusion that helped to drive the company's purchase of Columbia Pictures in 1989.

Now, however, Sony risks learning the wrong lessons from its history. If its desire to protect itself against piracy messes up its other plans, firms such as Apple will continue to design the devices that Sony ought to be making. It can reduce the danger of that by streamlining its media businesses, so that runaway prices for talent do not push up the costs of paid content too high. Sir Howard Stringer, Sony America's boss, is trying to do this in the music business. Last month, he brought in Andrew Lack, a television executive with few ties to the music industry, to make better business sense out of the unit.

Sony's film business, by contrast, is coming out of a bumper year, thanks to hits such as “Spiderman” and the sequel to “Men in Black”, backed up by successful DVD sales during the Christmas season. But the music industry should serve as a reminder that success in any content business can be fleeting, especially for a company without a sound business model and sufficiently close attention to costs. With piracy threatening its media businesses, and low-cost copycats snapping at its consumer-electronics devices, Sony is between a rock and a hard place. To steer successfully between them it must focus first on providing consumers with convenience and stylish design. Otherwise, Mr Idei will soon be going quiet again. Maybe for the last time.

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About sponsorship

The Bank of Japan

The only way is up

Feb 27th 2003 | TOKYO
From The Economist print edition

Kyodo MAXPP

Will the Bank of Japan's new governor, Toshihiko Fukui (above), do what is needed to resuscitate Japan's sick economy?

Get article background

ON FEBRUARY 24th, after much dithering, Junichiro Koizumi, Japan's prime minister, nominated Toshihiko Fukui as the new governor of the Bank of Japan. Subject to parliamentary approval, Mr Fukui, a central banker with 40 years' service, will succeed Masaru Hayami, whose term ends on March 19th. Mr Fukui's nomination, when it finally came, was no surprise. More intriguing were the nominations of Toshiro Muto, a heavyweight from the Ministry of Finance, and Kazumasa Iwata, an economist from the Cabinet Office, to fill the two deputy-governor slots that will also become vacant.

Mr Fukui and his colleagues face the monumental task of trying to halt Japan's deflationary spiral. Retail prices have been sliding for five years; wages are falling by around 1% a year. In nominal terms, GDP is smaller than in 1997; the real economy has grown by a mere 1% a year in the past decade. Since the bubble burst in 1990, commercial-property prices have fallen by 80% and the stockmarket by three-quarters. The government's efforts to stem the decline have so far been futile, and have left it with a debt mountain that is half as big again as Japan's GDP.

For its part, the Bank of Japan has lowered interest rates to almost zero. For the past two years, it has also been pumping money into the economy by increasing its monthly purchases of Japanese government bonds (JGBs). It now buys ¥1.2 trillion-worth ($10.3 billion) a month, equivalent to more than 40% of new issues (see chart, below). Yet although Japan's monetary base has expanded by over 40% since March 2001, the broad-money supply has grown by less than 6%. All the central bank's pumping has done little to get credit, and nominal demand, flowing again.

The bank, which gained its independence five years ago, has often fought with the government over policy. Its many critics believe that, by choosing the conservative Mr Fukui, Mr Koizumi has wasted a rare chance of changing a hidebound institution, in particular by failing to choose a governor committed to pursuing an inflation target above zero.

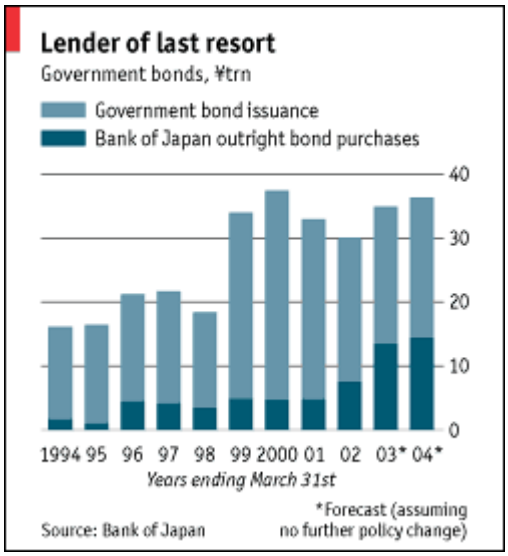
The central bank enjoys fairly broad discretion. It sets its own goals—currently, to eliminate deflation. Although the prime minister picks the members of the bank's nine-man policy board, they cannot be fired

until their five-year terms are up. Representatives from the government can speak at board meetings, but may not vote. As with the Bank of England and America's Federal Reserve (and in contrast to the European Central Bank), board members' votes and the minutes of policy meetings are published. However, unanimity in policy votes is very much the rule.

At first blush, little seems likely to change on Mr Fukui's watch. Like many in the Bank of Japan, he believes that Japan's problems are mainly structural, not monetary. Working the money pump even harder would therefore do little good. Deeply indebted companies do not want to borrow; weak banks, already saddled with enormous bad debts, are just as reluctant to lend. The way forward is to force banks to clean up their books.

It is possible that Mr Muto could pull the bank in a different direction. He spent 37 years at the Ministry of Finance, with which the Bank of Japan has crossed swords many times. He retains great influence in Japan's mightiest ministry and also has Mr Koizumi's ear. Some see him as the ministry's man inside the central bank, who might push the Bank of Japan, should the government decide to spend and borrow even more than it already does, into swallowing more JGBs, thereby holding down long-term interest rates.

Mr Iwata is more radical than either Mr Fukui or Mr Muto. He has not ruled out unlimited purchases of government bonds to combat deflation. Unlike the other two, he seems to support fiscal expansion as well as structural reform. He also has a powerful sponsor, Heizo Takenaka, the economics and financial-services minister.



All of this has the potential to upset the Bank of Japan's usual harmony. There is a chance of a stand-off, or at any rate an uneasy compromise between Mr Fukui and the central bank's traditionalists on the one hand, and Mr Muto and Mr Iwata on the other. Against that, optimists such as Paul Sheard, an economist at Lehman Brothers, believe that the new team might produce further monetary expansion, plus support for easier fiscal policy should the government choose to pursue it.

Especially with a finance-ministry minder next to him, Mr Fukui may now have his work cut out to preserve the central bank's independence. The bank is not only under pressure to lift its self-set cap on purchases of JGBs. Mr Takenaka also wants it to buy less conventional assets such as exchange-traded funds (index-linked equity funds).

Buying masses of exchange-traded funds would expose the central bank directly to the stockmarket, and so put its balance sheet at risk. Increased purchases of JGBs are also far from risk-free. Taken far enough, such purchases might help to create inflation. All well and good, but what if, one distant day, the central bank decides to tighten monetary policy again by selling some of those bonds? Inflation would surely mean higher bond yields—ie, lower bond prices—and a capital loss for the central bank.

Mr Fukui may have better luck with the Bank of Japan's other policy goal: keeping the financial system from collapse. Over the past five years, the Bank of Japan has done better at this than at fighting deflation. It stepped in several times as lender of last resort during the banking crisis in 1997, and it has since deluged weak banks that were unable to get funds in the call market with money.

Perhaps frustrated by eternal crisis management, the Bank of Japan has for years prodded the government to sort out the banks, through stricter inspections of bad loans. The need for bank reform, even if it involves injecting banks with public funds, is one point on which the three nominees seem to agree. They could even use their collective clout to push the government into cleaning up the banks. Now that would be a victory.

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Short-selling

Don't shoot the messenger

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Although it is under fire, short-selling should be encouraged

WHEN markets fall, short-sellers—who try to make money by selling shares they do not own, in the hope of buying them back at a lower price—become everybody's favourite whipping-boys. They are accused of aggravating pain by further driving down the market. Before long, people start muttering that something must be done to stop the tawdry practice.

Those who call for restrictions are often trying to run companies in trouble, or entire economies that are on the ropes. David Prosser, chief executive of Legal & General, a British insurer, called last summer for more “grit in the system” to work against short-selling. A little later, L&G tapped shareholders in a rights issue for £800m ($1.2 billion). Last year, Hans Eichel, Germany's finance minister, proposed banning short-selling in times of crisis. In 2002 the German stockmarket fell by 44%.

Admittedly, unflattering or even downright misleading rumours are sometimes spread about a company's financial state, in internet chat-rooms, research notes and through leaks to the media. By shorting the shares, so-called stockbusters hope to benefit. That said, during the boom years, similar tactics were used by those who were hyping shares, mainly tech stocks, for personal gain. Did they do any less damage?

In fact, short-sellers usually deserve more praise than blame. Sometimes they are among the first to spot trouble. For years Tyco vilified David Tice of Prudent Bear, a fund manager specialising in short-selling, for his negative stance on the company. Not long before Tyco went bankrupt it was still buying full-page advertisements to campaign against short-selling. Jim Chanos at Kynikos, another short fund, was one of the first to notice Enron's unorthodox accounting practices.

Nor are these the only examples. Owen Lamont of the University of Chicago studied 270 companies that fought short-sellers by demonising them publicly, hiring private investigators to spy on them, or taking them to court. The companies' shares fell on average by more than 40%, relative to the market, over the next three years.

Listen to the likes of Mr Eichel, and you might suppose that short-sellers drive down entire stockmarkets. In fact, they tend to focus on individual companies. Lately, it has been big institutional investors, such as insurance companies or pension funds, that have dragged down stockmarkets and amplified the effects of already falling prices. British insurers, which own about one-fifth of the shares listed on the London Stock Exchange, have sold billions-worth of equities to reduce their exposure to the stockmarket and to meet regulatory requirements on solvency. Short-sellers are minuscule in comparison, accounting for a mere 1-3% of the capitalisation of the FTSE 100.

Short-selling is similarly small in America. Short interest outstanding at the New York Stock Exchange is some 1.4% of the market's value. Jens Johansen of UBS Warburg estimates that short interest outstanding worldwide is about $230 billion, a tiny fraction of market capitalisation. About 45 hedge funds in America specialise in short-selling. These have about $4 billion under management, less than 1% of total hedge-fund assets.

In bull markets (remember them?), short-sellers can help to put a brake on irrational exuberance. Constraints on short-selling allowed stocks to become more overvalued during the most recent bull run, says Jeremy Stein of Harvard University. More short-selling then might have made the bear market less painful now.

America's restrictions on short-selling were introduced after the market crash of 1929. The Securities and

Exchange Commission (SEC) pioneered the “uptick” rule, which says that a share can be sold short only if its previous price move was upwards. The SEC denies that it has any plans further to tighten the rules on short-selling—although it is looking into stricter regulation of hedge funds, which do much of it. Eliot Spitzer, New York state's attorney-general, is looking at short-selling as part of his battle against Wall Street.

Japan's government toughened its rules on short sales as part of an anti-deflation package announced in February last year. This was a thinly veiled attempt to boost the stockmarket before March 31st, the end of most companies' financial year. The restrictions, requiring an uptick before shares can be shorted, brought Japan's rules into line with America's.

Despite Mr Eichel's frowns, short-selling is not proscribed in Germany. Mr Eichel did indeed include a temporary ban on short-selling in a draft financial-markets law last year, but the parliament's upper house rejected it. Short-selling is anyway rare in Germany: most banks will not lend shares to short-sellers.

Although Britain's Financial Services Authority (FSA) is sanguine about short-selling, it may require fund managers to disclose their aggregate short positions. “If you short more than 3% of the outstanding issue, you should disclose,” says Hugh Hendry of Odey Asset Management. This would help to uncover hedge-fund managers who collude to push down smaller stocks with poor liquidity.

Maybe other regulators should be as cool as the FSA. Beleaguered American companies are lobbying Mr Spitzer and the SEC to crack down on short-selling. Yet if anything, they should be doing the opposite. “Even scrapping the uptick rule would not unleash a torrent of short-selling,” says Mr Stein at Harvard. Mutual funds and most institutional investors consider shorting too risky, since losses are theoretically limitless when a shorted stock starts to rise. Investors should be grateful that somebody is willing to take such risks.

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Wall Street

No rest

Feb 27th 2003 | NEW YORK
From The Economist print edition

Legal torment continues for leading investment firms

AP

Spitzer's still haunting Wall Street

THESE are quiet times on Wall Street—except for lawyers at top investment banks. Even cases that seemed closed refuse to lie down. Three categories of litigation, concerning equity research, Enron and the allocation of initial public offerings (IPOs) during the boom, have had lawyers working all hours.

Consider first the charge that Wall Street analysts puffed shares that their investment-banking colleagues were trying to flog. In December, Eliot Spitzer, New York state's attorney-general, proudly announced a settlement, worth $1.4 billion, with Wall Street firms. Yet many issues were left unresolved—such as the exact crimes to which the firms would confess. Negotiations have been continuing ever since. The point, for the investment banks, is to limit their exposure to civil suits.

The latest leaks from the investigation say that Merrill Lynch, Credit Suisse First Boston and Citigroup will be found guilty of fraud. If so, it will place a huge burden on their defence in civil cases. The investment banks are also attempting to stop Mr Spitzer publishing all the internal documents he has subpoenaed. These were to have been released in early January, so the banks may have some hope. Mr Spitzer has offered no reason for the delay. Eager plaintiff attorneys are no doubt pressing for a fast resolution.

The primary target for civil suits will be Citigroup, if only because it has the most money. In an effort to simplify the litigation already filed, a federal judge in lower Manhattan has consolidated 77 lawsuits against Citigroup into nine. They allege that it provided conflicted advice to investors in WorldCom and Global Crossing, among other failed companies.

Second comes Enron. Litigation with the Securities and Exchange Commission (SEC) over investment banks' involvement with the collapsed energy firm is being sorted out. On February 20th Merrill Lynch agreed to pay $80m for its part in two Enron transactions. J.P. Morgan Chase and Citigroup are also said to be nearing a settlement. Each has put aside more than $1 billion to cover Enron-related costs—although, as with the research question, the big costs may come from civil suits.

Finally there are IPOs. On February 19th, another federal judge ruled that civil suits may proceed against Wall Street firms for their role in the IPOs of 300 technology companies between 1998 and 2000. The banks, wrote the judge, had a “coherent scheme to defraud investors”, which suggests that even higher litigation provisions may be needed. Meanwhile, the SEC is looking at whether several banks, notably J.P. Morgan, Goldman Sachs and Morgan Stanley, allocated shares in IPOs in return for promises to buy more

shares in the aftermarket—in effect, to support the price. The case will somehow have to distinguish the proper management of an offering from market manipulation.

The most perverse outcome of the investigations is its impact on investment research. Top analysts have been leaving Wall Street by the dozen, most of them helped through the door with a firm push. Without subsidies from investment-banking fees, research budgets are being crushed; there is little money for stars. Institutions have turned to research boutiques for advice. Unfortunately, these firms rarely cater for retail customers, the supposed beneficiaries of the crusade. Was this really the intended result?

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Initial public offerings

Lucky seven

Feb 27th 2003 | NEW YORK
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The IPO market has shrivelled. Wall Street's commissions haven't

SLUMPING share prices and the spectre of war have blighted the market for initial public offerings (IPOs). This year began with America's first IPO-free January since the bear market of 1974. Last year saw the smallest number of stockmarket debuts since 1991. Yet curiously, although the volume of IPOs has fallen, the commissions charged by investment banks for underwriting them have not.

Back in the heady days of the late 1990s, underwriters of around three-quarters of American IPOs charged almost exactly 7%. The rest were mostly billion-dollar deals in which the commissions clustered around 4%. That kind of coincidence has long fed suspicions of collusion in IPO underwriting, or at least of a lack of price competition. In 1999, indeed, the Department of Justice began a price-fixing investigation. However, this was later dropped.

There could be several reasons why commissions are so similar. Bankers and investors could all see what was being charged on other deals, and therefore knew the going rate. For young companies especially, there was a certain kudos in being served by a swanky Wall Street bank. During the technology boom, company founders and directors were much more concerned about banks' ability to sell their shares at a high price, and support them in secondary trading, than about costs: with some share prices “popping” by 100% or more on the first day of trading, who would bother haggling over a footling 7% commission?

These days, though, you might think a bidding war would break out on Wall Street for the few scraps of business that remain. But no. Jay Ritter, a finance professor at the University of Florida, says that banks are as likely as ever to charge 7%. Last year almost no IPOs under $200m had a “spread” of less than 7%.

So far this month, a handful of companies have gone public. Two of them, Florida Bancshares, a regional bank which sold $9m in shares, and Accredited Home Lenders, a mortgage outfit selling $77.2m, handed over precisely 7% of the proceeds to their bankers. Both are now trading below their offer price. These may have been great deals for the bankers; but investors probably see them differently.

How does price competition, or the appearance of it, still elude the IPO market? Mr Ritter reckons that, even now, companies are looking for two things in their underwriter: strong analyst coverage and prestige. Banks are supposed to be building ever higher walls between their investment bankers and their equity analysts. But an analyst's economic incentive to be positive about his banks' IPOs still remains. Mr Ritter says, “Rainmakers are always rewarded.”

Indeed, clever bankers might find good cause to raise prices in the current climate. With investors more sceptical of shares than ever, banks working harder to ensure that their clients have no skeletons in their cupboards, and companies needing persuasion of the benefits of a stockmarket listing, is it perhaps time to hail the 10% commission?

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British banking

Goodbye to all that

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Abbey National dumps the strategy it has followed since demutualisation

PA

Time for old Abbey habits

BRINGING in Luqman Arnold as chief executive of Abbey National last year was the banking equivalent of hiring the coach of a glamorous foreign football team to run, say, Queens Park Rangers. After being eased out of UBS, a Swiss bank, Mr Arnold was tipped for such smart jobs as the top spot at Credit Suisse. Instead he settled for struggling, downmarket Abbey National, a specialist mortgage lender that is Britain's sixth-biggest bank.

Chasing higher returns during the 1990s, Abbey let its wholesale-banking division invest heavily in junk bonds. It lost money on Enron. On February 26th Mr Arnold announced a pre-tax loss of £984m ($1.5 billion) for 2002 and a new strategy, which mostly consists of being nicer to customers than other British banks are.

Abbey's top brass reminded one City fund manager of Japanese bankers apologising tearfully for their mistakes, as Lord Burns, the bank's chairman, expressed his regret for the first full-year loss since the former building society (thrift) was demutualised in 1989. “It is deeply depressing to see how management wrecked the shareholders' investment,” says another money manager. Abbey National's share price has fallen by two-thirds in the past two years.

Blame, though, lies mostly with Ian Harley, the former chief executive, who failed to keep tabs on what Gareth Jones was getting up to in the wholesale bank. One Abbey insider points out that Mr Harley would have got rid of Mr Jones far sooner than he did if he had been able to win the backing of the bank's non-executive directors. At the time, he says, they regarded Mr Jones's then-profitable treasury-services operation as an example of shining entrepreneurialism.

The wholesale bank will continue to bleed into Abbey's results for some time. When Mr Arnold first looked into it, he says, what surprised him most was not so much the total size of the positions that the bank had taken as their high concentration. Only five names, for instance, make up £1.9 billion-worth of the bank's exposure to BBB-rated assets.

Abbey's new strategy is to turn its back on diversification—to sell the junk bonds, train- and aircraft-leasing businesses and so on—and shrink to its origins as a boring old British mortgage bank. Banks in Britain, says Mr Arnold, treat their customers badly; they push products at them with no real interest in

offering advice, and they bombard them with generic sales patter. When a customer wants advice, he says, “we put people in front of them who know less than they do.” To get its customers to buy more products—half of them buy only one at the moment—Abbey says it will spend money on training for its staff and introduce what Mr Arnold calls a “mass-advice model” to its branches.

Will this be enough to reverse the bank's fortunes and expand its revenues? Unfortunately for Abbey, others are already playing the same game. HBOS, which unveiled decent results this week, and NatWest have been at it for a couple of years. Even Lloyds TSB, which for years did nothing but cut costs and fire staff, has taken to investing huge sums in “customer relationship management” computer programs. Mr Arnold is adamant that he will protect the bank's profitability by wooing customers with advice and superior service, not with aggressive pricing. Simon Samuels, a banking analyst with Citigroup in London, says that this is unrealistic given that other British banks, such as HBOS, are competing with each other for customers on price.

Abbey National has already warded off two takeover attempts; from Lloyds TSB in 2001 and last year from Bank of Ireland. Mr Arnold should have a reasonable amount of time before another predator starts to circle. But faced with Abbey National's tired-looking retail branches and the nitty-gritty of cross-selling insurance products to its customers, he may soon wish he had chosen a more exciting employer—and an easier task.

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Credit Suisse

Casino closed

Feb 27th 2003
From The Economist print edition

After slashing costs, where now for the Swiss-American bank?

CREDIT SUISSE FIRST BOSTON (CSFB), the investment-banking arm of Credit Suisse, used to be “a giant casino”, admitted John Mack this week. That, of course, was before he agreed to be its chief executive in 2001. Since then nearly 4,000 people have been fired and a portfolio of crazy investments in property, distressed loans and private equity has been cut to a manageable $3 billion. Mr Mack has also nearly paid off all the ludicrous bonuses promised in order to retain staff after the acquisition of Donaldson, Lufkin & Jenrette, another investment bank, in 2000.

But can the downsized CSFB still compete with New York's biggest? It claims to rank among the top four globally in mergers and acquisitions, and equity and debt underwriting, the classic investment-banking disciplines. Unfortunately none of this is likely to yield much in the near term: activity and trading volumes are markedly down on two years ago.

Credit Suisse's fourth-quarter figures, published on February 25th, show the damage done by the excesses of its investment bank. The bank made a $600m provision against regulatory action and civil litigation in America and Britain in the wake of last year's scandals. Institutional investors have cut the amounts they are prepared to entrust to CSFB's discretionary management—to SFr279 billion ($200 billion) at the end of 2002 from SFr364 billion at the end of 2001.

Credit Suisse has been right to shrink its investment bank, and to cut costs and start to restructure its insurance arm, Winterthur. CSFB's revenues are too dependent on activities that are languishing and hardly covering costs. Winterthur is in the same boat as many European insurers, historically over-exposed to equity markets with little prospect of improving its investment returns from any other source.

Oswald Grübel, who runs the financial-services arm of Credit Suisse, believes there is still overcapacity of 25-30% in the Swiss banking market. A shrinking domestic deposit-base is hardly the best platform for a universal bank with global ambitions, especially when its local rival, UBS, seems to be doing much better. UBS has a more integrated approach, fewer workers and no loss-making insurer, and has so far escaped the Wall Street witch-hunt.

Credit Suisse still has to persuade investors that it is on the right track. Some are unhappy with the sharing of the chief executive role by Mr Mack and Mr Grübel, or with a chairman, Walter Kielholz, who seems to be little more than a figurehead. Others want a strategy beyond damage limitation, perhaps a spin-off of CSFB or Winterthur. But there are no takers in these dog days. In a prolonged bear market, sitting tight may be the least bad plan.

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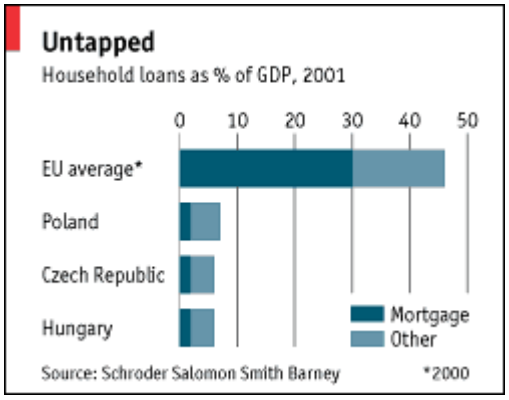
Central European retail finance

From communism to consumerism

Feb 27th 2003 | WARSAW
From The Economist print edition

Consumer lending is taking root in central Europe



EVEN in central Europe's better-off countries, GDP per head is much less than half that in the European Union. Yet central Europeans are fast developing the spending habits and aspirations of their western neighbours, to bankers' glee. In the western-owned shops that are sprouting everywhere, customers are offered not only groceries and consumer goods but also credit cards and personal loans. Car loans are also booming.

Between 1997 and 2001, lending to households in the Czech Republic, Hungary and Poland rose by 26% a year, according to Schroder Salomon Smith Barney, an investment bank. Yet there is still plenty of room for growth: relative to GDP, the value of outstanding loans in all three countries is less than one-sixth of the EU average (see chart). With margins on corporate lending thinning as interest rates fall, banks are turning eagerly to the retail market.

A handful of lenders are exploiting partnerships with large retailers to reach new clients. A relationship between Cetelem, the consumer-credit unit of BNP Paribas, a French bank, and Carrefour, a French hypermarket chain, has helped both companies to develop rapidly in Hungary and the Czech Republic by offering cards to shoppers. Household, an American consumer-finance giant, was helped in Hungary by an agreement with Dixons, a British electrical retailer. Both Household and Dixons are now about to enter Poland.

Consumer credit in central Europe is thought to be less risky than in America. Borrowers tend to be more middle-class and less indebted than their American counterparts. “This isn't sub-prime lending,” says Jonathan Baum, the head of European risk at GE Capital, an American lender prominent in the region.

However, the key, as everywhere, is canny “scoring”—assessing the riskiness of potential borrowers. Although local staff are being trained in the art, the lack of credit information is a hindrance. Poland, it is true, has had a western-style credit bureau since 1999, and the Czech Republic is setting one up, but these will be little use until borrowers build up a credit history. Debt-recovery procedures are another nuisance. Rather than take defaulting borrowers to the region's notoriously slow courts, lenders are investing heavily in systems to spot and chase late payments. All this, says Gilles Marion, the head of Cetelem's Polish operation, increases the cost of credit .

Still, the future looks rosy for lenders. Strong inflows of funds after central European countries join the EU next year are expected to boost consumer spending. Mortgages may be the next big thing. They are growing rapidly in Hungary, thanks to lavish government subsidies, and now many eyes are on the Poles, who are the least well-housed in the region and like to build their own homes. Courts' slowness in enforcing collateral laws and unclear property rights will add a local twist to the normal risks, but lenders are undaunted.

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Economics focus

Finding your niche

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The discovery of poor countries' industrial strengths is a matter of trial and error

WHEN developing countries turn to economists for advice on trade, they are usually pointed towards David Ricardo. According to his law of comparative advantage, formulated some 180 years ago, countries should specialise in whatever they are best at producing, leaving their trading partners to provide everything else. In Ricardo's illustrative model, the answers were clear: Portugal, blessed with a fine climate, should cultivate wine; England, blessed with capitalists, should manufacture cloth. The Portuguese gained from importing English cloth (even if they could make it more efficiently) because it freed them to concentrate on wine. As for the English, even the most ardent mercantilist would rather they left viniculture to others.

But if a country's God-given advantages were clear to Ricardo, they are less so in modern practice. Capital is mobile across borders, and the gifts of nature count for little now that manufacturing eclipses agriculture in world trade. A country's place in the global economy seems neither predestined nor predictable. As Ricardo Hausmann and Dani Rodrik, two economists at Harvard University, put it in a recent paper*, economic development is a haphazard process of “self-discovery”. Comparative advantage is almost impossible to spot in advance.

Bangladesh, for example, is good at exporting hats, having sold $175m-worth to America in 2000. At one level this is not surprising. Bangladesh is overcrowded and underserved by capital; much of its arable land is periodically under water. As any economist could tell you, it therefore has a comparative advantage in labour-intensive manufactures. But why does Bangladesh specialise in hats rather than, say, bed-sheets? And why did Pakistan, a country with a similar mix of land, labour and capital, export $130m-worth of bed-sheets to America in 2000 but a mere $700,000-worth of hats?

Mr Hausmann and Mr Rodrik cite many examples of countries that have happened upon a lucrative export niche—cut flowers from Colombia, software from India, footballs from Pakistan—to which raw factor endowments give only the roughest of guides. Nothing written by Ricardo, or by anybody theorising since, could have told a budding Bangladeshi entrepreneur to make hats rather than bed-sheets.

Sometimes governments try to force the issue. In 1896 Japan's rulers deemed that their country should have a steel industry to match the best in Europe. Imperial say-so substituted for economic know-how, but met with little success. The government went to great lengths to replicate European technology, importing German engineers, machines and designs. Only after a steel mill had been built did it become apparent that German mills could not run on Japanese coke.

Performing the hat-trick

Neither economists nor emperors can be relied upon to pick winners. The best bet is entrepreneurial trial and error. Messrs Hausmann and Rodrik build a theoretical model in which businessmen in a poor country can choose either to invest in a traditional domestic industry or to diversify into a modern industry in which there is no local history of expertise. The costs of production in the traditional industry are well-known; costs in the new industry are not. Entrepreneurs discover these costs only after they have sunk money into the project. Their investments are, in effect, industrial-scale experiments. Profitable or not, they reveal a country's strengths and weaknesses.

The authors think that entrepreneurs in developing countries may lack sufficient incentives to invest in

new industries. Businessmen will take the risk of innovation only if they have a chance of creating some sort of monopoly. They may be helped by patents, trademarks or copyright; if not, they will have an edge only until rivals catch up. In poor countries, the chances are that patents and so on will help less than in rich ones, largely because investors are trying out technology that already exists abroad. So the entrepreneur who first decides to export cut flowers from Colombia to America, for example, cannot hope to stay ahead of imitators for long. His fellow countrymen will rush to copy his business model, poach his staff and encroach upon the ground he has broken.

To create a greater incentive to experiment in new industries, say the authors, there may sometimes be a case for governments to protect companies in infant industries from unfettered competition. This does not mean tariffs, which protect all domestic companies to the same extent; rather, it implies finding ways to help innovators against domestic imitators. The trouble is that this is a much harder trick to pull off in practice than it looks in theory. Latin American development banks used to reserve preferential credit for the first domestic entrant in any industry—raising the potential profits available to innovators. Under such policies, Latin America became a veritable hothouse of industrial diversification. Unfortunately, governments did not weed out failed industrial experiments, instead keeping them alive alongside thriving ones.

Even successful policies can have damaging side-effects. Messrs Hausmann and Rodrik point to South Korea's willingness, during its drive for industrialisation from the 1960s, to use control of bank credit to reward successful companies and penalise poor performers. Yet by the 1990s the channelling of credit to favoured companies had wrought huge damage to the Korean financial system. Devising industrial policy, like divining comparative advantage, is a matter of trial and error. Many governments have tried; most have erred.

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* "Economic Development As Self-Discovery". National Bureau of Economic Research Working Paper, Number 8952, revised November 2002.

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About sponsorship

The Marjorie Deane internship

Feb 27th 2003
From The Economist print edition

Applications are invited for the 2003 Marjorie Deane internship. This award, financed by the Marjorie Deane Foundation, is designed to provide work experience for a would-be or junior journalist under 28, who will spend three months of the summer at *The Economist*, writing about finance. Applicants should send a letter introducing themselves, with an original article of about 1,000 words intended for the finance and economics section. Applications must reach us by April 7th, and should be posted to: The business affairs editor (Deane internship), *The Economist*, 25 St James's Street, London SW1A 1HG

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AIDS vaccines

Better luck next time

Feb 27th 2003
From The Economist print edition

The first big trial of an AIDS vaccine has ended in failure

Get article background

WELL, it didn't work. Expectations about the outcome of the first “phase III” clinical trial of an AIDS vaccine—the final hurdle to be leapt before the regulators pronounce judgment on a new medicine—had been managed downwards several months ago, so the outcome was not a surprise. A disappointment, yes. But then it would have been an impressive piece of luck (or of brilliant foresight by the researchers at VaxGen, the vaccine's maker), if the first AIDS vaccine to be tested in this way had been a success.

The firm tried to rescue some shreds of comfort from the data. It pointed to apparent efficacy among “blacks” and “Asians”. But these are groups of questionable biological validity, particularly since most subjects were American, with all the ancestral miscegenation that generally implies. On top of all this, the sample sizes of these retrospectively selected subgroups were not big enough for truly meaningful conclusions to be drawn. In the “black” subgroup, for example, there were only 13 infections: four among those who had received the vaccine and nine among a control group given a placebo.

At best, those results might suggest a direction for a future trial. But any assumption that, even if the vaccine did not work on whites, the road might now be open to vaccinate millions at risk in Africa would be deeply misguided.

In truth, it would have been misguided even if VaxGen's product had worked perfectly. The trial was carried out in the rich world (the United States including Puerto Rico, Canada and the Netherlands). It was therefore directed against the B subtype of HIV, the AIDS-causing virus, which is the strain that predominates in rich countries. But Africa, where the virus originated and where it has therefore become most diverse, is plagued by many strains. Unfortunately, B is one of the least of that continent's worries. A second trial organised by VaxGen is taking place in Thailand. This is tailored against both subtype B and subtype E, to suit local conditions. Once again, even if it works (the results are due in the autumn), it will not help Africa much.

The location of these trials is not a coincidence. The Americans, Canadians and Dutch could afford to buy a successful vaccine. So, at a pinch, could the Thais. VaxGen is, in fact, working on a vaccine for subtype C, which is the biggest problem in Africa. But that work is farther back in the pipeline, and even were it

successful, the vaccine would still need to be manufactured and distributed. That would require a big drug company to get involved. And big drug companies are not charities.

Carrots, not sticks

At first sight, developing an AIDS vaccine for Africa might look like a situation where the market will inevitably fail, making public-sector research and development the appropriate route. The public sector, however, has had 20 years since the discovery of HIV, and not a single phase III trial has emerged from it. Time, then, for some creative thinking.

A truly free market will not produce an AIDS vaccine for Africa, since the putative customers cannot afford the product. But that does not mean that market-like mechanisms are inappropriate. One way to provide a suitable incentive could be a “purchase fund” into which donors would pay money, and which would be legally obliged to buy predetermined quantities of any vaccine that met a set of criteria about effectiveness and appropriateness. That, however, would mean tying up precious capital against an uncertain future. An ideal solution would not do that, but would still look convincing enough for drug company bosses not to fret that politicians would find it easy to weasel out when the time came to pay up.

A better suggestion might be to get an institution such as the World Bank to act as guarantor. It would sign purchase deals with drug companies, payable when an effective vaccine was delivered. The vaccine could then be sold on at different prices in different countries, depending on the poverty of those countries. Africans would pay little (though probably not nothing). Brazilians and Thais, say, would pay a higher share of the real cost. The losses would ultimately be covered by rich-world taxpayers, and would constitute a form of foreign aid.

In theory, that ought to be enough. But in practice a second market-like mechanism might help. HIV is a hard virus to get a handle on, so lots of diverse approaches to designing a vaccine are needed, in the hope that one will succeed. Big pharmaceutical companies can provide some of this, but the true innovators are more likely to be found among biotechnology companies such as VaxGen.

In today's financial climate, however, venture capitalists are reluctant to take on even quite sensible biotechnological ideas, let alone flaky ones whose goal is to sell to the poor world. The way forward, therefore, might be a new style of venture capitalist that measures its returns in scientific success, rather than dollars. At the moment, one such exists: the International AIDS Vaccine Initiative (IAVI), which gathers money from foundations and other donors, and signs contracts with small firms that have interesting ideas. These contracts allow a successful firm to keep all its profits, but they impose tight restrictions on the price for which any vaccine might be sold in the poor world. If the firm breaks the contract, IAVI can give the patents to somebody else. A few more organisations of this kind would be welcome.

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Planck-scale physics

The long and the short of it

Feb 27th 2003
From The Economist print edition

Physicists have worked out how to look at the smallest sizes and shortest time that some of them believe can exist

ON A human scale, an atom is inconceivably small. But size is relative. On the Planck scale—the smallest that physical theory recognises—atoms are huge. At this scale, named after Max Planck, the founder of quantum theory, many physicists envisage space and time as being grainy, rather than continuous. But the size of the grains of space compared with an atom would be about the same as the size of atoms compared with the sun. And the size of the grains of time would compare to a hundredth of a trillionth of a second much as that hundredth of a trillionth of a second does to the age of the universe.

These minuscule grains would be a consequence of Werner Heisenberg's famous uncertainty principle, an important part of quantum theory. The uncertainty principle suggests that you cannot know both the precise location and the precise velocity of anything. The dimensions of the grains are the minimum possible compromise between location and velocity.

If, that is, such grains exist. For quantum theory has a competitor, the theory of relativity (at bottom, a theory of gravity), which assumes that space is continuous. It is the dream of many theorists of fundamental physics to reconcile quantum theory with relativity, and thus produce a grainy theory of quantum gravity. Doing so means knowing what is going on at the Planck scale. And that is hard, because, in physics, probing smaller and smaller things requires bigger and bigger energies.

Against the grain?

The energy that would be needed to probe the granularity of space is known as the Planck energy. Unfortunately, even the biggest particle accelerators in existence probe energies which are only about a millionth of that. The lack of a reality check which this causes has led theorists so far into the deep end of mathematical speculation that many have started to question if what they are doing is still physics.

In the past ten years, this has begun to change. Physicists have realised that, if brute force is not going to work, they will have to be clever. They have found a number of places, both in the night sky and in the laboratory, where the nature of space and time at the Planck scale would have indirect, but observable effects. What they have seen so far places tight restrictions on the form that any theory might take. Most theorists seem pleased—they are doing physics again. More cynical experimenters say that the golden age of theory is over, now that the days of freewheeling mathematical carousing are drawing to a close.

In the March 10th issue of *Astrophysical Journal Letters*, Richard Lieu and Lloyd Hillman of the University of Alabama, in Huntsville, will describe a new method they have used to look at Planck time. Dr Lieu supposed that light, travelling over very long distances, would have to spread out a bit if there was any uncertainty in time. This effect would normally be too small to measure, but Dr Lieu realised that “phase coherence”—a precise synchronisation of the waves that make up a beam of light—is necessary in order for rings, known as diffraction rings, to show up in a telescope. He then examined a picture taken by the Hubble space telescope of a galaxy several billion light-years away. This galaxy has the characteristic ring. So, says Dr Lieu, time (and therefore space) is continuous, not grainy. If true, that is a spanner in the works for those designing quantum gravity.

However, not everyone agrees with Dr Lieu. Jack Ng and his colleagues at the University of North Carolina, Chapel Hill, have written a paper arguing that Dr Lieu overestimated by a factor of several million the effect that fluctuations in space and time would have on light. According to Dr Ng, the Hubble

observation says nothing about whether time is discrete or continuous. Dr Lieu points out that Dr Ng's paper has not been accepted by a refereed journal, and is thus unreliable. Dr Ng retorts that he is surprised Dr Lieu's paper got past the refereeing process. Time, discrete or continuous, will tell who is right.

Another way of placing constraints on quantum gravity has been found by Ted Jacobson and his colleagues at the University of Maryland, College Park. In a recent paper, Dr Jacobson argues that observations made of synchrotron radiation produced by the Crab nebula (the remnants of a supernova observed in 1054) limit the granularity of space.

Synchrotron radiation is caused when electrons are accelerated by a magnetic field. The energy of the radiation depends on the energy of the electrons. Because radiation from the Crab nebula is so energetic, the electrons that created it must have been travelling very close to the speed of light—so close that the difference between the two speeds would bump up against Planck-scale graininess, and show up in the spectrum of the radiation. Such effects do not, in fact, show up.

Nor need physicists look only to the sky to see Planck-scale effects. Fabio Benatti and Roberto Floreanini, of the National Institute of Nuclear Physics in Trieste, Italy, propose using atom interferometers to search for granularity. These machines work by separating, then recombining, two beams of precisely synchronised atoms of, say, neon. When the beams merge, they form an interference pattern. The precise nature of this pattern, Dr Benatti says, depends on Planck-scale physics.

The last word may, nevertheless, come from a satellite. Because the early universe is believed to have undergone a period of rapid inflation, features that were Planck-scale may have been magnified to the point where they are visible as blips in the cosmic microwave background, an electromagnetic echo of the Big Bang.

An American satellite called WMAP (the Wilkinson Microwave Anisotropy Probe) has just provided a reasonably detailed picture of this background radiation. Whether WMAP's picture is detailed enough to discern the relevant blips (assuming they are there) is not yet clear. But, even if it is not, the aptly named Planck, a European satellite scheduled to be launched in 2007, should do the business. Commenting on the uncertainty principle, and by inference on its malevolent effects for relativity, Einstein once famously said “God does not play dice”. Soon, it should be possible to see if he was right.

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DNA

A double twist

Feb 27th 2003
From The Economist print edition

The fiftieth anniversary of understanding the structure of DNA

FIFTY years ago, on February 28th 1953, an unknown British physicist called Francis Crick walked into his local pub in Cambridge, England, and announced that he had discovered the secret of life. Dr Crick and his American colleague, James Watson, had just worked out the structure of an equally unknown molecule called deoxyribonucleic acid. Their result was published in *Nature* on April 25th 1953.

The names Crick, Watson and DNA are rather better known today than they were half a century ago. For although Dr Crick's pub boast was an exaggeration, it was not a huge one. Knowing the structure of DNA has helped to explain how heredity works, and has proved crucial to an understanding of biology at the molecular level. So the end of February marks the start of a period of global biological festivity that will culminate on April 25th in a gala party for the subject's great and good, organised in London by *Nature*'s publishers. Be there, or be a double helix.

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CJD

The gift of prophecy

Feb 27th 2003
From The Economist print edition

Human “mad cow” disease may not kill as many as was once feared

NIELS BOHR, among others, is credited with observing that predictions are hard to make—especially about the future. They are particularly hard where a disease as baffling as variant Creutzfeld-Jakob disease (vCJD) is involved. This nasty neurodegenerative condition, linked to “mad cow” disease, has killed 94 people in Britain since 1995, with another 28 deaths suspected. The question is, how many more will succumb?

In 1998, Azra Ghani, Roy Anderson and their colleagues at Oxford University predicted that as many as 500,000 could die of vCJD by 2080. Now, things seem to have changed for the better. In the latest issue of the *Proceedings of the Royal Society*, the group, which has moved to Imperial College, London, has revised its projections to a maximum of 7,000 deaths by 2080, with 10-80 deaths occurring within the next two years.

The earlier estimates were based on limited data collected in the first days of the epidemic, when the number afflicted could well have risen dramatically. Since 2000, however, the number of deaths has actually fallen (see chart). That requires a rethink. If the initial, gloomy predictions had been correct, then 40-50 deaths a year from the disease would now be expected, rather than the smaller numbers that have actually been observed.

The story could change again, though. All the victims tested so far have carried a particular genetic trait that affects their prion proteins, the molecules involved in the disease. Dr Ghani's calculations assume that only the 40% of the population which carries this trait is susceptible. If it turns out that the rest are not resistant, but simply take longer to develop symptoms, the eventual number of afflicted would necessarily be greater.

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About sponsorship

Venice

Is there life after death?

Feb 27th 2003
From The Economist print edition

Preserving an old city means interfering with it all the time

IF YOU could sex cities, Florence would be male and Venice female. In 1833 Chateaubriand thought Venice was a female city situated at the water's edge about to be extinguished with the day. Henry James wrote that Venice was like a woman of whom you are tenderly fond. But there is a less sentimental conception of Venice's femininity: of a woman of easy virtue who clings on to many clients despite the ravages of time which are treated by means of shrewdly applied face lifts. There is enough lingering charm to toy with the memories of her admirers. But this Venice is dying.

Venice: Fragile City 1797-1997
By Margaret Plant

Yale University Press; 448 pages; $55 and £29.95

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All these images and many more are to be found in Margaret Plant's thoroughly and lovingly researched, thoughtful and hugely compendious history of modern Venice. It is surprisingly revealing and ought to make lovers of an unchanged and unchanging Venice reconsider their enthusiasms and prejudices. Ms Plant is professor emeritus in art history at Monash University in Melbourne but she is a social historian at heart and her canvas embraces literature, music, politics, architecture and town planning as well as arts and crafts. She begins by describing the plucky survival of Venice after the fall of the Serene Republic to Napoleon's army in 1797. Napoleon, the liberator, threw open the gates of the city's Jewish ghetto, but in other respects he behaved like a pig. He stole the four bronze horses from the basilica of San Marco, destroyed the boat-building capacity of the Arsenale, and demolished a church in Piazza San Marco to build a memorial to himself. The French, who believed Venice was “a city against nature” wanted to build wide thoroughfares and create open spaces—a large part of Castello was knocked down to create the public garden. But those were the last major upheavals in Venice. It had become an Austrian colonial possession and remained one until the Risorgimento. In the absence of political clout, Venice succumbed to the tourist trade—something it had always an instinctive feeling for.

Tourism became an insidious influence on the debate between the party that wanted Venice to be a creature of its past which concentrated on conservation and restoration, and those who preferred to improve the quality of life even if that meant changing the face of the place. The planning policy was *dov'era, com'era*—where it was, as it was. The English, led by John Ruskin, were leading reactionaries. In the 1850s Italian politicians accused the English of meddling; they were still doing so 120 years later.

In 1852 Ruskin doubted that the ducal palace, which he thought the finest building in the world, would

still be standing five years later. But facsimile capitals were used to support the building and new stone versions of decorative statues were made for the Porta della Carta—and were restored by the Venice-in-Peril fund late in the 20th century. Those victories for the preservers were confirmed in the 1880s. A radical municipal plan for new housing designed to create space and let air circulate, and for a sewage system that did not discharge into the canals was proposed and rejected because of the wholesale demolition that would have been required.

Ms Plant declares that the 1880s were the key moment in the modern history of Venice because that decade confirmed it was to be a dead city. “It began quite precisely in 1887, when the city was fetishised and its face turned resolutely to the past. At that point zealously guarded Venice became a commodity city, a package of the total picturesque...it became a virtual cliché to declaim that Venice had the world as its audience; its own citizens were confirmed as a lower order.” To prove the point, the *campanile* in Piazza San Marco was rebuilt as an exact replica after it collapsed, as shown in the famous Zaghis photograph above, in 1902.

The fascists tried to alter the policy, developing a port on the mainland in Marghera, but pollution from chemical plants attacked the stone fabric of the city. In 1966 a great flood deluged Venice, and when it was repaired it looked exactly as it had done. After decades of restoration it looks as well as it ever has. Its international audience luxuriates in Venice. But the numbers of tourists rise uncontrollably and the city is flooded with monotonous regularity. The Berlusconi government has promised to build the gates at the lagoon entrances to reduce the threat of flooding; believe it when you can see it.

Since Venice has always preferred romance to reality and retained a morbid fascination with death, Ms Plant's conclusion is apt enough: “Meanwhile the seas are rising. In the city of the apocalypse the four golden horses are at the ready, pawing at the porch of St Mark, waiting to haul the city out of the waters and into the sky.”

Venice: Fragile City 1797-1997.
By Margaret Plant.
Yale University Press; 448 pages; $55 and £29.95

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About sponsorship

Multinational corporations

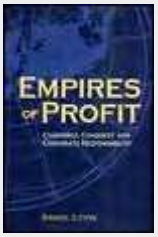
Balancing trick

Feb 27th 2003
From The Economist print edition

AT THE start of “Empires of Profit”, Daniel Litvin writes that he is aware of no similar treatment of his topic. That is an unlikely claim for a book about globalisation. How many books have been published on this subject? Yet Mr Litvin's approach is indeed novel. He looks at the difficulties thrown up by globalisation not just as they present themselves today but as they have been experienced since the time of the East India Company. He is concerned not with the costs and benefits of economic integration but with the way political and cultural dimensions of globalisation test the managers of multinational companies. And he looks not at the history of any one company but at a series of episodes, each involving a different entity at a different time.

In this way, Mr Litvin—formerly an environment and resources correspondent of *The Economist*—has achieved an improbable feat. He has found a fresh perspective on the subject, and a revealing one too.

Empires of Profit: Commerce, Conquest and Corporate Responsibility
By Daniel Litvin



Texere; 340 pages; $27.95 and £18.99

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The book's main theme is that, despite the appearance of power and competence they show to the world, multinational companies usually end up out of their depth. The East India Company never intended to rule India by military force: at the start, the company's managers were interested only in peaceful trade. The company became a ruler by accident, as local managers, too distant and dispersed for effective supervision, became increasingly entangled in a series of local disputes. That was an extreme case, to be sure, but a similar pattern appears time and again: ill-prepared central managers, local officers facing unexpected difficulties on the ground, political pressures at home and abroad, all resulting in a catalogue of unintended and sometimes tragic consequences.

The details vary greatly, of course, as the book ranges over the experiences of other companies at other times: Cecil Rhodes's British South Africa Company towards the end of the 19th century; the United Fruit Company in Central America in the 1950s; Aramco in the 1960s and 1970s; Nike in Asia in the 1980s and 1990s; and others. Mr Litvin's main theme is compellingly illustrated by his case studies. These companies were much less in control of events than either they or their critics would wish to believe, and their confusion in each case had much to do with the cultural and political ignorance of the bosses at home.

If the book has a weakness, it is one that many readers, unlike this reviewer, may regard as a strength: Mr Litvin makes painstaking efforts to remain neutral in the current debate between globalisers and anti-globalisers. Prudent as this may be in several ways, it puts too many interesting and important questions off-limits. This book may not have been the place to discuss whether multinational investment on the whole benefits poor countries—but Mr Litvin is plain wrong to believe, as he apparently does, that this question is not susceptible to objective analysis. A book on globalisation that shies away from such discussion for fear of betraying bias is bound to seem incomplete. Still, those who do want to argue about such questions can do so far more knowledgeably having read the book. Engagingly written as well as original in approach, “Empires of Profit” is warmly recommended.

CLIVE CROOK

Empires of Profit: Commerce, Conquest and Corporate Responsibility.
By Daniel Litvin.
Texere; 340 pages; $27.95 and £18.99

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About sponsorship

The Vietnam war

Getting out is never easy

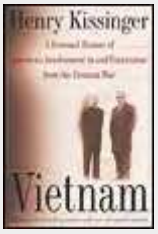
Feb 27th 2003
From The Economist print edition

LIKE Robert McNamara, America's other main Vietnam policymaker still living, Henry Kissinger keeps returning to that conflict. Mr McNamara writes mea culpas; Mr Kissinger no-holds-barred apologias.

Drawing in very large part upon the three volumes of memoirs he began publishing in 1979, Mr Kissinger maintains his basic premise: America's ultimate failure resulted from an unprecedented and unforeseeable refusal by Congress to provide open-ended support to its South Vietnamese ally, including the continued use of American firepower.

When President Nixon took office in 1969, with Mr Kissinger at his side, more than 500,000 American troops were in South Vietnam. The new team accepted that its task was to maintain America's honour and its credibility with allies. Mr Kissinger treated the view of the doves—that a reasonable American approach to negotiations could lead to a compromise peace—as a fantasy: North Vietnam's leaders, he rightly believed, wanted nothing short of total victory. Yet—and this was his and his president's dilemma—a divided America was in no position to prevent communist victory in Vietnam at anything approaching acceptable cost to itself.

Ending the Vietnam War: A History of America's Involvement in and Extrication from the Vietnam War
By Henry Kissinger



Simon & Schuster; 640 pages; $18

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Within two months of taking office the new administration decided therefore on Vietnamisation, the gradual withdrawal of American forces in the hope that the South Vietnamese could mount their own defence. The programme rested on the unlikely premise that an ineffectual South Vietnamese government could somehow struggle on in the absence of half a million American soldiers when it had barely survived with their help. Mr Kissinger knew the outcome would be highly uncertain. As he says here, the best that might be achieved would be a stalemate. Yet what followed was another six years of war, in which tens of thousands of Americans and far larger numbers of Vietnamese soldiers on either side lost their lives.

Mr Kissinger tells us, admirably enough, that his intention is to provide a new generation with “as accurate an account as possible”. Yet, as a key player, it is inevitable that his account should in places read more like heroic than academic history, the harder questions of explanation and justification going unanswered. Was the small chance of an indisputably large prize—South Vietnamese survival and American vindication—worth those further lives?

Mr Kissinger's account of the Christmas bombing of 1972 is another example of where the analysis is not pushed far enough. In October of that year he had negotiated a peace agreement, which he terms “excellent” and “the best deal we [were] ever going to get”. The South Vietnamese government balked, however. In a message omitted from his argument here, though quoted in A.J. Langguth's book “Our Vietnam: The War 1954-1975” (Simon & Schuster, 2000), Mr Kissinger told the president: “While we have a moral case for bombing North Vietnam when it does not accept our proposals, it seems to be really stretching the point to bomb North Vietnam when it has accepted our proposals and when South Vietnam has not.” Nonetheless, Mr Kissinger soon found himself acceding to the resumption of strategic bombing.

North Vietnam was pounded with 20,000 tonnes of bombs in 11 days. Some 1,500 civilians died and a hospital was hit. Twenty-six American aircraft including 15 B-52s were shot down. The net outcome was the signing in January 1973 of essentially the same agreement reached in October. Mr Kissinger makes no serious effort to reconcile his different statements nor to explain how the bombing affected America's

cause. For the peace agreement, Mr Kissinger shared the Nobel prize, and two years later North Vietnamese tanks rolled into Saigon.

Ending the Vietnam War: A History of America's Involvement in and Extrication from the Vietnam War. By Henry Kissinger.
Simon & Schuster; 640 pages; $18

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About sponsorship

Alban Berg

Lyric gift

Feb 27th 2003
From The Economist print edition

He refused to let modernism's head rule its heart

FOR much of the past century, music lovers heard the phrase “second Viennese School” with sinking hearts. It signified a radical style of composition which aimed at redressing the swooning clichés of late romanticism, first with atonality, then with the rigorous new language of the 12-tone system, founded not on traditional harmony but abstract arrangements of pitches. Spearheaded by a formidable composer, teacher and polemicist, Arnold Schoenberg, it inspired controversy and occasional concert hall riots. The Viennese public was wholly unprepared to accept the spiky dissonances of Schoenberg and his devoted students, Anton Webern and Alban Berg, as the true music of their time, in the august line of Haydn, Mozart and Beethoven.

In general, that resistance has been repeated around the world, with the striking exception of the operas of Berg, which have achieved and maintained repertoire status. According to second Viennese orthodoxy, Berg was something of a hybrid, more romantic and wilful than the pristine formality of Webern. Typically, Pierre Boulez, doyen of contemporary music, admired Webern's purity, while wryly describing the ardour and variety of Berg's work as like a novel. But by the same token, Mr Boulez warmly praised Berg's “combination of immediate expressiveness with outstanding structural prowess”.

It is just that combination that makes Berg's works speak to audiences, despite their undoubted complexity. They are clearly products of a man whose own life possessed a romantic intensity. Tall, elegant and sensitive, Berg saw himself as an artist early on, with the kind of emotional turmoil that went with the territory: he had fathered an illegitimate daughter and attempted suicide by the time he was 18. It seemed appropriate that as a fledgling composer he concentrated on songs. Though when he came to study with Schoenberg the master regarded this tendency as a defect, Berg never lost that sense of music as proceeding from passionate situations. Even his abstract music is rooted in human occasions—his violin concerto, a concert hall favourite, is an elegy on the death of a friend's daughter, inscribed “to the memory of an angel”. His Lyric Suite for strings is permeated with a covert musical code, enshrining the extra-marital affair which dominated the last decade of his life, before his untimely death from an infection at the age of 50 in 1935.

Operatic peak

Thus it is no surprise that Berg's gifts are expressed with particular power in opera. His first stage work, “Wozzeck”, depicts the grim fate of a soldier, a helpless *Untermensch* treated as an object by his superiors and trapped by poverty and ignorance. It would be easy to turn such a figure into a piece of agit-prop, and Berg's searing atonal score unsparingly conveys a prevailing mood of anxiety and despair. But the work is also rich and multi-faceted, reflecting his character's struggle for comprehension. Berg's libretto pares the action down to a series of graphic scenes—Wozzeck's encounters with his mistress Marie and their little son, his overbearing officers, the strutting drum-major who seduces Marie and beats Wozzeck. The sense of suffering and injustice is increased by poignant moments of yearning and pathetic insight, before the bleakly inevitable denouement: Wozzeck murders Marie and drowns himself.

Premiered in Berlin in 1925, Berg's opera both shocked and dazzled. Though traditionalists were unnerved by its musical language, they could not deny its dramatic power, and the uncompromising opus was performed 150 times across Europe in the next decade, a remarkable record for a contemporary work. And its surprising popularity has continued. Last autumn, Antonio Pappano, new musical director of London's Royal Opera, chose “Wozzeck” for his inaugural season and scored an outstanding triumph, assisted by the commanding performance of one of the world's leading baritones, Matthias Goerne, in the title role.

The same kind of popularity and success has attended Berg's second and final opera, “Lulu”. Not quite finished at his death, a version completed by Friederich Cerha was only presented after his widow's demise in 1976. But since then it has flourished, despite a subject arguably even more scandalous—and less apparently political—than “Wozzeck”. Lulu is the eternal *femme fatale*, an irresistible sexual force who unhinges any man she meets and blithely spreads devastation and death in her wake. Her effect is almost unintentional—the lust she triggers is simply ungovernable, a natural magnetism. Berg himself described his heroine as “innocent, but the root of all evil”, and his opera traces in harrowing, mesmerising detail her rise and fall from street urchin to society queen to impoverished prostitute and victim of Jack the Ripper.

Again, Berg's score is incomparably vivid and varied, intense but full of lyric passion. It also displays the same kind of powerful symbolic structure that marks his libretto—the music imitates in its overall shape the arc of Lulu's fate and the characters are doubled, so that the same singer plays both her first protector and Jack the Ripper. This unblinking but understanding view of sexuality has attracted audiences and opera companies—there have been productions this past 12 months in London, Vienna and New York, among others. And like “Wozzeck”, “Lulu” confirms Alban Berg not as a composer of any school, style or period, but as a classic, able to move and inform by the abiding power of his achievement.

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About sponsorship

South Africa

Nettlesome

Feb 27th 2003
From The Economist print edition

A History of Inequality in South Africa 1652-2002.
By Sampie Terreblanche.
University of Natal Press; 527 pages; 225 rand

CRITICS on the left of the African National Congress (ANC) government argue that most black South Africans are now worse off, economically, than they were under apartheid. It is a worrying claim, but one which has always lacked convincing evidence. This book by Sampie Terreblanche, a silver-haired and genial Afrikaner professor, is the best effort yet to muster ammunition for it. A man who once advised white rulers on economics has become a champion of the poor, and an opponent of the new government's economic policies.

EPA

Jesus, can you spare a smile?

Much of his book explains how the deep inequalities were entrenched by more than three centuries of black exploitation. He concedes that since this government took office in 1994 the political and legal lot of all black South Africans has greatly improved. He also notes an emerging class of rich black South Africans, and that the average level of personal income is rising. But that hides a messier picture. Per-capita income of the poorest two-thirds, inevitably almost only black people, has dropped in the past eight years, so inequality is worsening. The upshot is that a rigid racially divided society has become a highly stratified class society.

Any visitor can see that this is at least partly true. In every city black and white mingle at posh clubs, restaurants and shopping malls within a short distance of wretched black townships. Formal unemployment is rising to about 30%, even higher for black people and in rural areas where 600,000 jobs have been lost since 1994. Violent crime—again mostly affecting poor blacks—is still going up. The poorest are hit worst by AIDS. Social spending is up sharply from 51% of the budget (excluding debt payments) in 1990 to 60%, but too few services are actually delivered.

It need not be like this, says Mr Terreblanche, but Thabo Mbeki and the other ANC leaders struck a deal to please businesses at the expense of the poor. Taxes are low, there is too little public spending as apartheid-era debts are paid, little capital has been put into black hands, there are no job-creating public works schemes yet. Mr Mbeki is piqued by this criticism, partly because newspapers have brayed about a betrayal of the poor. Through another minister he let it be known he thinks that Mr Terreblanche may be trying to defeat “the process of transformation”.

That is a nasty accusation in post-apartheid South Africa, where nobody admits ever supporting white rule. But ministers also say that Mr Terreblanche gives too little credit for impressive gains since 1994: lowish inflation, a growing economy, 1.3m extra telephone connections, clean water for an extra 9m people, electricity for 1.5m more. As for raising taxes, revenue is booming faster than officials can spend it. And most low-level ANC members seem happy with the way the economy is run. Trevor Manuel, the finance minister, topped an internal party poll in December. Number two was a rich black businessman, Cyril Ramaphosa.

Mr Terreblanche may be out of touch with the need for an economy like South Africa's to engage in open trade. But his genuine concern for the poor has touched a nerve in government. Ministers have rushed in the past few weeks to buy the first editions of this book. An official review of the first ten years of democracy is beginning. Expect a firm rebuttal.

A History of Inequality in South Africa 1652-2002.
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About sponsorship

Kemmons Wilson

Feb 27th 2003
From The Economist print edition

Charles Kemmons Wilson, hotel pioneer, died on February 12th, aged 90

AP

THE pleasure of staying in a hotel was nicely put by Jan Morris, a travel writer. She saw a hotel as the modern equivalent of a caravanserai, an inn where a traveller could reliably expect to be rested and refreshed after a long day. “Staying in a hotel is more fun than accepting a bed in Clarissa's guest room and having a nice long chat after dinner...where I would also be obliged to admire the holiday photographs, drool over the baby, put up with bath water that is less than scalding and even, at worst, helping with the washing up...The hotel requires nothing of me (except hard cash or credit card).”

For the millions of American families who in the years after the second world war were discovering their country by car, Clarissa's spare room was at least free. On a long trip Kemmons Wilson made with his family in the summer of 1951, he was angered that the motels he usually stayed in made an extra charge of $2 for each of his five children. The $6 room became a $16 room (and rather overcrowded). Nor were the motels generally appealing. Mr Wilson said they had few amenities and were none too clean.

In 1952 he built a hotel not far from his home in Memphis but close to a highway to catch the passing trade. This was the first Holiday Inn, named after a Bing Crosby film popular at the time that Mr Wilson had enjoyed. Today there are Holiday Inns throughout America and some 50 other countries. They offer as routine the facilities that were available only in posh hotels in a few big cities when Mr Wilson made his frustrating journey in 1951: swimming pools, air conditioning, nurseries. Mr Wilson made no extra charge for children who shared their parents' room, and their meals were free. He scrapped plans to put fly swats in every room (wrong message) and install trampolines (too dangerous).

Like the Big Mac, another American invention that has gained a world market, the Holiday Inn was based on a simple idea. For years thousands of travellers must have grumbled about the grubby premises they were offered. Mr Wilson saw an opportunity and provided an alternative. He probably would not have minded his hotels being compared to Big Macs. “You can cater to rich people,” he said, “and I'll take the rest. The good Lord made more of them.”

An American oasis

The growth of the United States as a nation of innkeepers has been a phenomenon of the past 50 years. Especially abroad, American hotels aim to provide a secure oasis of familiar comforts and food, just as British hotels did for their own people in the days of empire. Mr Wilson's pioneering ways encouraged others to provide for the traveller. One was Jay Pritzker (Obituary, January 28th 1999), who started the Hyatt chain in 1957 and had the idea of building hotels next to airports.

Both men had built successful careers before they took an interest in hotels. They had the money, or access to money, to put up hotels without delay. Mr Pritzker was born into a rich family and made it richer. Mr Wilson had a humbler start; so humble that his rags-to-riches life reads like the archetypal tale of a struggle to the top in the land of opportunity. In his autobiography “Half Luck and Half Brains” he tells of selling magazines door to door after his father, an insurance salesman, had died, leaving the family poor. He left school at 17 and, starting with a capital of $50, gradually built a fortune by investing in increasingly ambitious enterprises.

First there was a popcorn machine in a local cinema. Then there were slot machines and a jukebox business and an ice-cream parlour. At the time of his move into the hotel business he was building homes for sale. When he achieved the American businessman's accolade of being chosen by *Time* magazine for its cover story, he was asked the secret of his success. Mr Wilson had a ready answer; in fact 20 answers, a list of tips for getting ahead that he happily shared with any patient listener. It amounted to a folksy philosophy that did not owe a lot to Plato. “There are two ways to get to the top of an oak tree,” is tip number five. “One way is to sit on an acorn and wait; the other is to climb it.”

Mr Wilson reckoned that as well as shaking up the hotel industry he had invented franchising, but Ray Kroc of McDonald's and Harland Sanders of Kentucky Fried Chicken put in claims (and Charles the Great may have started it around 800 when he granted land rights to his supporters). Mr Wilson was certainly a pioneer in franchising hotels, and set up a training school to ensure quality.

Eventually the Holiday Inn brand passed into the ownership of Six Continents, a British-based outfit that calls itself the world's leading global hotel company, and was this week being threatened with a possible takeover bid by a firm headed by Hugh Osmond, a Briton with an eye for opportunity. Mr Osmond said that Six Continents had been shown to be “poor operators, poor financiers and poor deal-makers”. What would Kemmons Wilson have made of that? Probably he would not be too surprised. It was the chancy way of his world. “Opportunity comes often. It knocks as often as you have an ear trained to hear it, an eye trained to see it, a hand trained to grasp it, and a head trained to use it.” Success tip number 14.

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Overview

Feb 27th 2003
From The Economist print edition

Oil prices jumped to their highest level since the Gulf war. Worries about conflict in Iraq and strong demand for heating oil in America pushed the price of West Texas Intermediate to $37.70 a barrel on February 26th.

In **America**, war jitters and rising fuel costs contributed to a sharp decline in consumer confidence. The Conference Board's index declined from 78.8 in January to 64.0 in February, a nine-year low that may herald weaker growth in consumer spending. Rising energy prices pushed consumer-price inflation in the year to January up to 2.6%, its highest level since September 2001. But core inflation, which excludes energy and food prices, stayed at 1.9%, the lowest recorded for three years.

The **German** economy stagnated in the fourth quarter of 2002 and grew by just 0.2% in the year as a whole. But business confidence is recovering, according to the Ifo index, which rose in February to a seven-month high of 88.9. Comments by Wim Duisenberg, the president of the European Central Bank, at the weekend G7 summit in Paris, raised hopes that the ECB will cut interest rates on March 6th in order to stimulate **euro-area** growth, which is being hit by the rise in the euro. The 12-country zone ran a current-account surplus of *euro*62 billion ($58 billion), about 1% of GDP, in 2002. The surplus, the first in the short life of the monetary union, is likely to shrink this year as the strong euro curbs export growth and encourages imports.

The **yen** strengthened after Toshihiko Fukui was appointed the next governor of the Bank of Japan. Foreign-exchange dealers think that Mr Fukui is unlikely to succeed in combating deflation through a radical switch in monetary policy that would weaken the yen. On February 25th, it reached a six-month high of ¥117 against the dollar.

The **pound** continued to decline on the foreign-exchange markets, reaching a four-year low of *euro*1.46. Currency traders have become gloomier about **Britain's** economic prospects. Business investment fell by 10.1% in 2002, the sharpest decline since records began in 1965. GDP growth last year was revised down from 1.7% to 1.6%, the lowest since 1992. Booming household and public spending more than offset the collapse in business investment and the drag on growth from falling exports and rising imports.

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Output, demand and jobs

Feb 27th 2003
From The Economist print edition

% change on year ago

	GDP			The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate		
	1 qtr*	1 year		2002	2003	latest		latest		latest		year ago
Australia	+ 3.5	+ 3.7	Q3	+ 3.7	+ 3.2	+ 1.6	Q3	+ 5.4	Q4	6.1	Jan	7.0
Austria	+ 0.3	+ 1.2	Q3	+ 0.8	+ 1.3	+ 1.7	Nov	+ 0.6	Nov	4.2	Dec	3.9
Belgium	+ 1.8	+ 0.9	Q3	+ 0.7	+ 1.4	- 0.8	Dec	- 0.9	Nov	11.9	Jan†	10.9
Britain	+ 1.3	+ 2.1	Q4	+ 1.7	+ 2.3	- 1.4	Dec	+ 4.2	Jan	5.1	Dec††	5.2
Canada	+ 3.1	+ 4.0	Q3	+ 3.3	+ 3.1	+ 4.9	Nov	+ 2.4	Nov	7.4	Jan	7.9
Denmark	- 2.6	+ 1.1	Q3	+ 1.6	+ 1.7	- 1.7	Dec	+ 2.4	Dec	5.4	Dec	5.1
France	+ 0.9	+ 1.7	Q4	+ 1.0	+ 1.5	- 0.1	Dec	- 1.9	Dec	9.1	Dec	8.8
Germany	- 0.1	+ 0.5	Q4	+ 0.2	+ 0.6	- 1.4	Dec	- 3.2	Dec	10.3	Jan§	9.6
Italy	+ 1.1	+ 0.5	Q3	+ 0.4	+ 1.2	+ 2.1	Dec	+ 1.9	Nov†	8.9	Oct	9.3
Japan	+ 2.0	+ 2.6	Q4	- 0.3	+ 0.2	+ 6.4	Dec	- 3.0	Dec	5.5	Dec	5.5
Netherlands	+ 0.4	+ 0.3	Q4	+ 0.2	+ 0.9	- 6.8	Dec	- 2.5	Dec	4.3	Jan**	3.4
Spain	+ 3.2	+ 1.8	Q3	+ 2.0	+ 2.3	+ 2.5	Dec	+ 4.8	Nov†	12.0	Dec	10.7
Sweden	+ 1.6	+ 2.0	Q3	+ 1.8	+ 2.0	- 2.0	Dec	+ 5.9	Dec	5.1	Jan†	4.4
Switzerland	+ 1.4	+ 0.8	Q4	nil	+ 0.9	- 3.5	Q3	- 2.8	Dec	3.8	Jan†	2.6
United States	+ 0.7	+ 2.8	Q4	+ 2.4	+ 2.5	+ 2.0	Jan	+ 4.9	Dec	5.7	Jan	5.6
Euro area	+ 1.2	+ 0.9	Q3	+ 0.7	+ 1.3	- 0.5	Dec	- 0.4	Nov	8.5	Dec	8.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.9	+ 2.3	Q3	na	na	+ 7.9	Dec	+ 2.0	Nov	9.5	Jan†	9.9
Greece	na	+ 3.6	Q3	na	na	+ 5.0	Dec	na		na		na
Iceland	na	+ 3.62001		na	na	+12.2	2001	na		3.8	Jan	2.4
Ireland	na	+ 6.9	Q3	na	na	- 6.6	Dec	- 0.4	Dec	4.5	Jan	4.2
Luxembourg	na	+ 1.02001		na	na	+ 1.9	Nov	- 2.3	Sep	3.4	Dec†	2.7
New Zealand	+ 5.0	+ 5.0	Q3	na	na	+ 5.1	Q3	+ 7.3	Q4	4.9	Q4	5.4
Norway	- 0.9	+ 1.0	Q3	na	na	- 4.4	Dec	+ 3.2	Dec	3.7	Q4	3.3
Portugal	na	- 0.5	Q3	na	na	- 1.8	Dec	- 3.5	Dec	6.2	Q4†	4.2

*% change at an annual rate. † Not seasonally adjusted. ‡ New series. †† Oct-Dec; claimant count rate 3.1% in Jan. § EU harmonised rate 8.6% in Jan. **Nov-Jan, new series

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Prices and wages

Feb 27th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 3.0	Q4	+ 3.1	+ 3.0	+ 2.7	+ 1.6	Q4	– 0.7	+ 3.9	Q4	+ 4.9
Austria	+ 1.8	Jan	+ 2.1	+ 1.8	+ 1.6	+ 1.4	Jan	– 0.4	+ 2.2	Dec	+ 2.7
Belgium	+ 1.2	Jan	+ 2.9	+ 1.7	+ 1.3	+ 1.1	Jan	– 1.6	+ 2.2	Q4	+ 3.1
Britain	+ 2.9	Jan	+ 1.3	+ 2.1	+ 2.6	+ 1.6	Jan	– 0.6	+ 3.7	Dec	+ 3.4
Canada	+ 3.9	Dec	+ 0.7	+ 2.2	+ 2.6	+ 2.8	Dec	– 2.4	+ 2.1	Nov	+ 3.1
Denmark	+ 2.6	Jan	+ 2.5	+ 2.4	+ 2.1	+ 1.3	Jan	+ 0.6	+ 3.9	Q3	+ 4.3
France	+ 2.0	Jan	+ 2.2	+ 1.9	+ 1.5	+ 2.1	Jan	– 1.1	+ 3.4	Q3	+ 4.2
Germany	+ 1.1	Jan	+ 2.1	+ 1.3	+ 1.0	+ 1.2	Jan	+ 0.2	+ 2.7	Dec	+ 2.2
Italy	+ 2.8	Jan	+ 2.4	+ 2.6	+ 2.2	+ 1.5	Dec	– 1.3	+ 2.1	Dec	+ 2.8
Japan	– 0.3	Dec	– 1.2	– 0.9	– 0.7	– 1.0	Jan†	– 2.7	– 1.9	Dec	– 1.9
Netherlands	+ 2.5	Jan*	+ 4.0	+ 3.8	+ 2.5	+ 4.0	Dec	– 2.2	+ 3.4	Dec	+ 4.9
Spain	+ 3.7	Jan	+ 3.1	+ 3.5	+ 2.9	+ 2.0	Dec	– 0.8	+ 3.8	Q3	+ 3.6
Sweden	+ 2.8	Jan	+ 2.9	+ 2.4	+ 2.1	– 0.6	Dec	– 0.8	+ 3.9	Nov	+ 3.0
Switzerland	+ 0.8	Jan	+ 0.5	+ 0.7	+ 0.7	– 0.2	Jan	– 1.4	+ 2.5	2001	+ 1.3
United States	+ 2.6	Jan	+ 1.1	+ 1.6	+ 2.1	+ 2.8	Jan	– 2.7	+ 2.7	Jan	+ 3.8
Euro area	+ 2.1	Jan	+ 2.0	+ 2.2	+ 1.7	+ 1.5	Dec	– 1.0	+ 3.3	Q3	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.4	Jan	+ 2.3	na	na	+ 1.4	Dec	– 2.7	+ 3.3	Q4	+ 4.5
Greece	+ 3.1	Jan	+ 4.4	na	na	+ 1.4	Dec	+ 1.5	na		na
Iceland	+ 1.5	Feb	+ 8.9	na	na	+ 2.7	Jan	+11.4	+ 5.5	Jan	+10.0
Ireland	+ 4.8	Jan	+ 4.9	na	na	– 0.6	Dec	+ 0.2	+ 6.2	Q3	+ 8.1
Luxembourg	+ 2.3	Jan	+ 2.3	na	na	– 0.2	Nov	– 1.0	+ 3.5	Nov	+ 4.2
New Zealand	+ 2.7	Q4	+ 1.8	na	na	– 1.7	Q3	+ 6.2	+ 2.1	Q4	+ 2.2
Norway	+ 5.0	Jan	+ 1.3	na	na	+11.6	Jan	– 8.2	+ 5.0	Q3	+ 4.8
Portugal	+ 4.0	Jan	+ 3.5	na	na	+ 2.3	Jan	– 0.5	+ 0.2	Dec*	+ 2.2

*Revised series.

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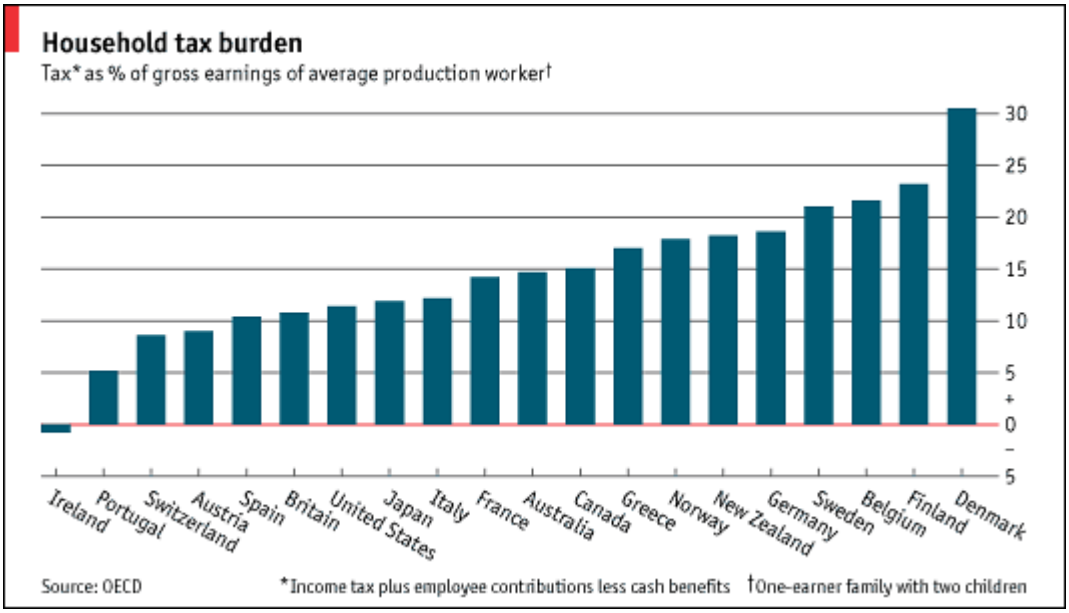
Household tax burden

Feb 27th 2003
From The Economist print edition



The direct-tax burden on industrial workers with a family has fallen in most countries over the past two years. The decline has been greatest in Ireland, where an employee on average blue-collar wages with two children now gets more in cash benefits than he pays in direct taxes and social-security contributions. The direct-tax burden has also fallen in the United States and Britain; but it has risen in New Zealand.

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Money and interest rates

Feb 27th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Feb 26th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 9.2	+10.6	Dec	4.70	4.33	4.40	5.15	6.02	6.15
Britain	+ 5.1	+ 6.4	Jan	3.66	4.00	3.28	4.19	4.97	5.88
Canada	+ 6.7	+ 4.9	Jan	2.87	2.10	3.45	4.99	5.37	6.87
Denmark	+ 7.4	+ 9.1	Jan	2.85	3.70	2.60	4.11	5.12	6.77
Japan	+23.6	+ 2.0	Jan	0.03	0.06	0.04	0.79	1.50	0.90
Sweden	+ 0.6	+ 2.8	Nov	3.51	3.97	3.45	4.36	5.32	3.86
Switzerland	+13.2	+ 8.0	Jan	0.57	1.70	0.23	2.25	3.49	3.25
United States	+ 2.9	+ 6.2	Jan	1.24	1.78	1.53	3.75	4.88	5.99
Euro area†	+ 9.8	+ 6.8	Dec	2.55	3.37	2.29	3.86	4.90	4.37

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.74%, Japan No.246 0.79%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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Stockmarkets

Feb 27th 2003
From The Economist print edition

Market indices

	Feb 26th	2002-03 high	2002-03 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,804.2	3,440.0	2,780.5	- 1.6	-18.5	-16.5	- 1.1
Austria (ATX)	1,144.1	1,357.2	1,003.7	- 1.2	-34.1	+ 0.3	+21.6
Belgium (Bel 20)	1,628.0	2,899.8	1,628.0	- 9.7	-55.8	-41.5	-29.1
Britain (FTSE 100)	3,593.3	5,323.8	3,480.8	- 1.8	-48.2	-31.1	-25.1
Canada (Toronto Composite)	6,508.3	7,958.1	5,695.3	- 0.8	-42.9	-15.3	- 9.6
Denmark (KBX)	148.8	233.4	148.8	- 5.2	-50.7	-33.8	-19.7
France (SBF 250)	1,788.8	3,081.9	1,788.8	- 6.6	-59.3	-40.0	-27.3
(CAC 40)	2,658.6	4,688.0	2,656.5	- 7.0	-61.6	-42.5	-30.3
Germany (DAX)	2,450.2	5,462.6	2,450.2	- 6.6	-69.6	-52.5	-42.5
Italy (BCI)	1,051.2	1,513.0	974.4	- 1.9	-51.8	-26.7	-11.1
Japan (Nikkei 225)	8,356.8	11,979.9	8,303.4	- 3.7	-78.5	-20.7	-11.3
(Topix)	818.4	1,139.4	760.1	- 4.1	-71.6	-20.7	-11.3
Netherlands (AEX)	253.4	531.2	253.4	-11.4	-63.9	-50.0	-39.4
Spain (Madrid SE)	607.0	848.1	568.5	- 3.8	-47.0	-26.4	-10.8
Sweden (Affarsvarlden Gen)	134.8	236.8	122.7	- 5.7	-66.3	-41.8	-27.5
Switzerland (Swiss Market)	4,052.0	6,694.1	4,052.0	- 3.8	-51.8	-36.9	-22.6
United States (DJIA)	7,807.0	10,635.3	7,286.8	- 2.4	-33.4	-22.1	-22.1
(S&P 500)	827.6	1,172.5	776.8	- 2.1	-45.8	-27.9	-27.9
(NASDAQ Comp)	1,303.7	2,359.5	1,114.1	- 2.3	-74.2	-33.2	-33.2
Europe (FTSE Eurotop 300)*	748.0	1,279.7	748.0	- 4.8	-56.1	-40.7	-28.1
Euro area (FTSE Ebloc 100)*	623.3	1,125.1	623.3	- 6.4	-59.8	-44.0	-32.1
World (MSCI)†	741.4	1,024.4	703.7	- 2.6	-48.8	na	-26.1
World bond market (Salomon)‡	541.3	541.3	430.3	+ 0.9	nil	na	+23.1

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Feb 27th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2002	Current account The Economist poll % of GDP, forecast 2003	Exchange rate trade-weighted† 1990=100 Feb 26th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Feb 26th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2002‡
Australia	− 5.3 Dec	− 14.3 Q3	− 3.9	− 4.2	77.3	74.9	1.65	1.94	2.61	1.78	1.41	0.1
Austria	+ 0.4 Nov	+ 0.8 Dec	− 0.1	− 0.4	101.3§	100.3	0.93	1.16	1.47	–	0.79	-1.6
Belgium	+ 17.5 Dec	+ 18.0 Nov	+ 5.2	+ 5.1	100.7§	99.0	0.93	1.16	1.47	–	0.79	nil
Britain	− 51.8 Dec	− 20.5 Q3	− 1.6	− 1.8	100.5	107.5	0.63	0.71	–	0.68	0.54	-1.4
Canada	+ 34.7 Dec	+ 12.4 Q3	+ 1.9	+ 1.9	78.6	75.4	1.50	1.61	2.37	1.61	1.28	0.6
Denmark	+ 8.0 Dec	+ 5.0 Dec	+ 2.2	+ 2.0	104.9	101.6	6.88	8.60	10.9	7.43	5.88	2.2
France	+ 9.7 Dec	+ 28.3 Dec	+ 1.7	+ 1.7	103.7§	101.7	0.93	1.16	1.47	–	0.79	-2.7
Germany	+119.3 Dec	+ 50.4 Dec	+ 2.1	+ 1.8	100.8§	98.6	0.93	1.16	1.47	–	0.79	-3.7
Italy	+ 10.5 Nov	− 6.4 Dec	− 0.2	− 0.2	74.0§	72.6	0.93	1.16	1.47	–	0.79	-2.3
Japan	+ 94.1 Dec	+115.0 Dec	+ 2.8	+ 2.8	133.1	126.9	117	135	185	126	–	-7.9
Netherlands	+ 29.0 Dec	+ 9.1 Q4	+ 3.1	+ 2.6	99.9§	98.0	0.93	1.16	1.47	–	0.79	-0.8
Spain	− 38.7 Nov	− 15.3 Nov	− 2.2	− 2.1	75.5§	74.3	0.93	1.16	1.47	–	0.79	nil
Sweden	+ 15.0 Jan	+ 9.9 Dec	+ 3.5	+ 3.2	79.8	76.6	8.43	10.5	13.3	9.09	7.19	1.7
Switzerland	+ 4.1 Jan	+ 29.8 Q3	+10.3	+10.8	116.8	111.5	1.36	1.71	2.15	1.46	1.16	na
United States	−484.3 Dec	−462.2 Q3	− 4.8	− 5.0	107.6	124.9	–	–	1.58	1.08	0.85	-3.1
Euro area	+ 97.7 Dec	+ 60.2 Dec	+ 0.7	+ 0.8	86.5	77.8	0.93	1.16	1.47	–	0.79	-2.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.2 Dec	+ 10.3 Dec	na	na	79.6§	78.5	0.93	1.16	1.47	–	0.79	3.2
Greece	− 21.5 Dec	− 9.0 Dec	na	na	58.3§	57.5	0.93	1.16	1.47	–	0.79	-1.1
Iceland	+ 0.1 Dec	nil Q3	na	na	92.1**	83.4	77.9	100.9	123	84.0	66.5	0.3
Ireland	+ 35.9 Nov	+ 0.1 Q3	na	na	90.3§	87.7	0.93	1.16	1.47	–	0.79	-0.5
Luxembourg	− 3.0 Nov	+ 2.1 Q3	na	na	100.7§	99.0	0.93	1.16	1.47	–	0.79	1.8
New Zealand	− 0.7 Dec	− 1.7 Q3	na	na	98.2	82.7	1.77	2.39	2.80	1.91	1.51	1.6
Norway	+ 26.8 Jan	+ 25.9 Dec	na	na	103.8	98.8	7.07	8.92	11.2	7.63	6.04	12.4
Portugal	− 12.9 Nov	− 9.8 Nov	na	na	91.1**	90.2	0.93	1.16	1.47	–	0.79	-3.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, December average. ‡OECD estimate. **IMF, October average.

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The Economist commodity price index

Feb 27th 2003
From The Economist print edition

1995=100

	Feb 11th*	Feb 18th	Feb 25th†	% change on one month	% change on one year
Dollar index					
All items	79.8	78.9	78.3	+ 0.4	+15.3
Food	82.0	81.4	79.3	– 1.6	+16.3
Industrials					
All	76.8	75.4	76.9	+ 3.4	+14.1
Nfa‡	79.8	79.2	79.8	+ 4.0	+18.3
Metals	74.2	72.3	74.5	+ 3.0	+10.5
Sterling index					
All items	77.8	78.1	78.6	+ 4.8	+ 4.6
Euro index					
All items	98.0	97.0	95.8	+ 1.2	– 6.8
Yen index					
All items	103.1	99.9	97.8	– 0.6	+ 0.8
Gold					
$ per oz	363.25	344.75	352.45	– 4.4	+19.1
West Texas Intermediate					
$ per barrel	35.45	36.84	36.04	+10.4	+67.2

* Revised. † Provisional. ‡ Non-food agriculturals.

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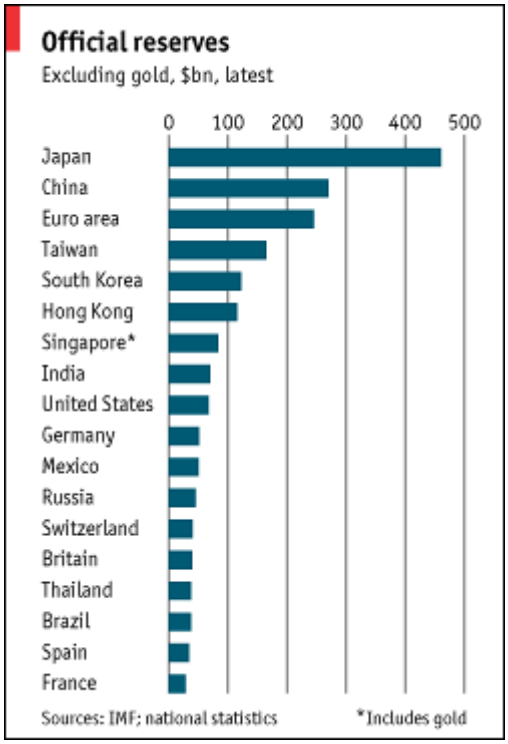

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Overview

Feb 27th 2003
From The Economist print edition

Beset by political turmoil, **Venezuela's** economy is in a tailspin. GDP fell by 16.7% in the year to the fourth quarter of 2002. The trade surplus in the fourth quarter was a third lower than in the previous three months because of falling oil shipments.

Argentina is showing signs of recovery. In the year to January, industrial production surged by 11.4%, the highest in three years.

In **China**, which has been suffering from deflation, consumer prices rose by 0.4% in the 12 months to January.

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South Korea

Feb 27th 2003
From The Economist print edition

Despite the sluggish world economy, South Korea's GDP grew by 6.1% in 2002. According to the OECD, the country's growth is likely to remain on track. In its latest survey, the OECD forecasts that South Korea's economy will grow by 5.8% in 2003 and by 5.7% in 2004. It gives warning, however, that the country risks higher inflation. Growth in wages has accelerated sharply and property prices have soared.

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Economy

Feb 27th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.2	Q4	+14.8	Jan	+ 0.4	Jan	+26.5	Jan	+17.4	2001	269.9	Oct
Hong Kong	+ 3.3	Q3	– 7.2	Q3	– 1.6	Jan	– 6.9	Jan	+16.5	Q3	115.6	Jan
India	+ 5.8	Q3	+ 5.0	Dec	+ 3.2	Dec	– 7.3	Dec	+ 4.5	Q3	69.9	Jan
Indonesia	+ 3.8	Q4	+ 7.1	Dec‡	+ 8.7	Jan	+25.4	Dec	+ 7.5	Q3	30.5	Dec
Malaysia	+ 5.6	Q4	+ 8.0	Dec	+ 1.7	Jan	+13.4	Dec	+ 6.6	Q3	33.5	Jan
Philippines	+ 5.8	Q4	– 5.0	Dec	+ 2.7	Jan	+ 1.6	Dec	+ 6.1	Sep	13.2	Jan
Singapore	+ 3.0	Q4	+13.5	Jan	+ 0.9	Jan	+ 9.8	Jan	+18.9	Q3	84.0	Jan
South Korea	+ 5.8	Q3	+ 3.6	Jan	+ 3.8	Jan	+10.8	Jan	+ 6.5	Nov	122.8	Jan
Taiwan	+ 4.2	Q4	+ 8.5	Jan	+ 0.8	Jan	+16.3	Jan	+25.8	Q4	164.8	Jan
Thailand	+ 6.0	Q3	+12.0	Dec	+ 2.2	Jan	+ 4.9	Jan	+ 7.6	Dec	38.1	Dec
Argentina	–10.1	Q3	+11.4	Jan	+39.6	Jan	+16.4	Dec	+ 7.0	Q3	9.5	Jan
Brazil	+ 2.4	Q3	+ 5.5	Dec	+14.5	Jan	+14.1	Jan	– 6.3	Jan	37.8	Dec
Chile	+ 1.8	Q3	+ 7.2	Dec	+ 3.0	Jan	+ 2.5	Jan	– 0.6	Q4	16.4	Jan
Colombia	+ 1.9	Q3	+ 0.6	Nov	+ 7.4	Jan	nil	Nov	– 1.5	Q3	10.9	Jan
Mexico	+ 1.9	Q4	+ 1.7	Dec	+ 5.2	Jan	– 8.6	Jan	–16.1	Q3	50.6	Dec
Peru	+ 6.3	Dec	+11.7	Dec	+ 2.3	Jan	+ 0.3	Dec	– 1.0	Q3	9.1	Dec
Venezuela	–16.7	Q4	–10.5	Oct	+33.8	Jan	+13.9	Q4	+ 7.6	Q4	9.1	Nov
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.1	Nov	– 7.8	Nov	+ 0.1	Q3	13.0	Oct
Israel	+ 1.3	Q4	+ 1.3	Dec	+ 5.6	Jan	– 6.6	Jan	– 1.9	Q3	23.8	Jan
South Africa	+ 3.0	Q4	+ 1.5	Dec	+13.7	Jan	+ 3.8	Dec	nil	Q3	5.9	Dec
Turkey	+ 7.9	Q3	+13.5	Dec	+26.4	Jan	–13.6	Nov	+ 0.1	Nov	26.8	Dec
Czech Republic	+ 1.5	Q3	+ 6.6	Dec	– 0.4	Jan	– 2.3	Jan	– 4.2	Q3	24.3	Jan
Hungary	+ 3.4	Q3	+ 6.9	Dec	+ 4.7	Jan	– 3.3	Dec	– 2.7	Dec	15.3	Jan
Poland	+ 1.6	Q3	+ 4.2	Jan	+ 0.4	Jan	–10.3	Dec	– 5.7	Dec	29.3	Jan
Russia	+ 4.3	Q3	+ 4.9	Jan	+14.3	Jan	+46.2	Dec	+30.3	Q3	45.5	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	– 0.5	Jun	+ 3.4	Jan	– 1.3	Jan	+ 2.7	2002†	8.1	Dec
Saudi Arabia	+ 1.2	2001	na		– 0.9	Oct	+39.2	2001	+ 9.4	2001	20.6	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Feb 27th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 26th		Dec 31st 2001	
	Feb 26th	year ago	Feb 26th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.1	na	1,581.7	+0.2	– 7.6	– 7.6
Hong Kong	7.80	7.80	12.3	1.44	9,116.3	–3.3	– 20.0	– 20.0
India	47.7	48.7	75.5	5.80	3,260.5	–1.3	– 0.1	+ 1.0
Indonesia	8,888	10,183	14,067	13.99	397.5	–1.1	+ 1.4	+ 18.7
Malaysia	3.80	3.80	6.01	3.10	650.7	–1.6	– 6.5	– 6.5
Philippines	54.3	51.3	86.0	7.75	1,000.3	–2.8	– 14.4	– 18.7
Singapore	1.74	1.84	2.75	0.69	1,287.1	–2.2	– 20.7	– 15.6
South Korea	1,185	1,322	1,876	4.54	590.3	–1.8	– 14.9	– 5.7
Taiwan	34.7	35.1	55.0	1.45	4,456.7	–2.1	– 19.7	– 19.1
Thailand	42.7	43.8	67.6	1.79	356.0	–4.1	+ 17.2	+ 21.3
Argentina	3.18	2.12	5.03	5.50	585.8	+0.9	+ 98.3	– 37.5
Brazil	3.58	2.38	5.67	26.25	9,994.9	–2.5	– 26.4	– 52.5
Chile	754	674	1,193	2.64	5,003.5	–0.3	– 7.3	– 18.7
Colombia	2,951	2,310	4,671	7.69	1,599.8	+1.0	+ 49.4	+ 15.3
Mexico	11.03	9.09	17.5	9.30	5,869.8	+0.2	– 7.9	– 23.5
Peru	3.48	3.47	5.51	3.80	1,528.4	–0.4	+ 30.0	+ 28.6
Venezuela	1,598	1,050	2,529	30.74	8,149.7	+0.1	+ 24.0	– 41.2
Egypt	5.53	4.63	8.74	8.27	6,058.7	+0.1	+ 14.9	– 4.8
Israel	4.85	4.61	7.67	6.03	313.7	–1.0	– 29.8	– 36.1
South Africa	8.0	11.4	12.6	13.60	8,276.6	–3.4	– 20.7	+ 19.5
Turkey	1,615,000	1,410,000	2,556,222	42.00	11,291.9	–2.7	– 18.1	– 26.2
Czech Republic	29.4	36.7	46.5	2.40	478.9	–0.2	+ 21.4	+ 46.8
Hungary	226	283	357	6.46	7,262.9	+0.0	+ 1.8	+ 24.0
Poland	3.88	4.19	6.15	6.26	13,660.0	–1.3	– 1.9	– 0.2
Russia	31.6	31.0	50.0	18.00	378.9	+2.6	+ 50.9	+ 45.7
EMF (MSCI)*	1.00	1.00	1.58	na	281.7	–1.3	na	– 11.3
EMBI+†	1.00	1.00	1.58	na	240.0	+1.5	na	+ 19.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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